United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

75-7038 ORIGINAL

To be argued by
EDWARD J. ROSS

United States Court of Appeals
For the Second Circuit

75-7038 75-7055 75-7057

HOWARD BERSCH,

Plaintiff-Appellee,

against

DREXEL FIRESTONE, INC., DREXEL HARRIMAN RIPLEY, BANQUE ROTHSCHILD, HILL SAMUEL AND CO., LIMITED, GUINNESS MAHON & CO., LIMITED, PIERSON, HELDRING & PIERSON, SMITH, BARNEY & CO. INCORPORATED, J. H. CRANG AND CO., INVESTORS OVERSEAS BANK LIMITED,

Defendants,

ARTHUR ANDERSEN & CO., I.O.S., LTD., and BERNARD CORNFELD,

Defendants-Appellants.

Appeal from the United States District Court for the Southern District of New York

BRIEF FOR DEFENDANT-APPELLANT ARTHUR ANDERSEN & CO.

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BRIEF FOR DEFENDANT-APPELLANT ARTHUR ANDERSEN & CO.

Preliminary Statement

This is a §1292(b) interlocutory appeal from a decision and order of Hon. Robert L. Carter, U.S.D.J., entered November 27, 1974 (252A-282A),* not yet reported. Appeal

* Numbers with the suffix "A" refer to Appellants' Appendix.

was permitted by this Court's order of January 7, 1975, which also consolidated such appeal with separate appeals by defendants I.O.S., Ltd. ("IOS") and Bernard Cornfeld.

Statement of Issues Presented for Review

1. Does the District Court have subject matter jurisdiction under the securities acts over an action based on alleged misrepresentations contained in foreign public offerings of common shares of a foreign corporation, which does not have an office in the United States; whose securities are not traded in the United States, either on an exchange or over the counter; where there has never been a market in the United States for such securities; and where such securities were bought outside the United States by 99,614 non-resident aliens, and also by 386 Americans, of whom 374 were non-residents who bought outside the United States, and 11 were residents who bought in the United States; and where all such American buyers were directors, officers or employees of such foreign corporation or other insiders who bought under the prospectus specifically designed for sales to them?

2. Can plaintiff, a resident American citizen, represent a class of 100,000 purchasers of stock of a foreign corporation which did not have an office in the United States, where the stock was purchased in foreign offerings made by three prospectuses, and where 99,614, or over 99.6% of the class, consist of non-resident aliens who bought their stock abroad; 374, or 0.3% of the class, consist of non-resident Americans who were directors, officers, employees or other insiders of such foreign corporation, who also bought abroad; and a maximum of 11 of the class are resident Americans, who were also such directors, officers, employees or insiders, and who may have bought in the United States?

3. Can the District Court exercise judicial jurisdiction over some 99,614 non-resident aliens of the United States, who purchased in a large number of countries in Europe,

Asia, Africa, Australia and South America, stock of a foreign corporation which does not have an office in the United States, and bind such non-resident aliens to a judgment rendered by such court, because a resident citizen brought suit in such court as their representative?

4. Can a judgment rendered by the District Court be made binding on foreign class members in their native countries, especially where they are nationals of countries which do not recognize the procedures of Rule 23(c)(2) and (3) and would give no recognition to such a judgment?

5. Is plaintiff, a resident American citizen, a proper class representative for a class consisting of 100,000 persons, of whom 99,614 are non-resident aliens of the United States, and is the class manageable?

Statement of the Case

Nature of the Case

This action was commenced December 9, 1971, as a class action, by plaintiff Bersch, who on September 3, 1969 bought and paid for 600 shares of common stock of IOS. The action is based on alleged misrepresentations in three separate offering prospectuses, two dated September 24, 1969, and one dated September 22, 1969, three weeks after plaintiff bought his shares. The three offerings aggregated 11,000,000 shares, at $10 a share, or a total of $110,000,000.

5,600,000 shares were sold in a primary offering underwritten by defendants Drexel Firestone, Inc. (formerly Drexel Harriman Ripley) ("Drexel"), and five other underwriting houses; namely, Banque Rothschild, Hill Samuel & Co. Limited, Guinness Mahon & Co. Limited, Pierson, Heldring & Pierson and Smith, Barney & Co. These six underwriters are called the "Drexel Group" (252A, fn. 1). Such 5,600,000 shares were sold under a prospectus solely to aliens residing in Europe, Asia and Australia, and no shares were sold to anyone in the United States or to Americans anywhere.

1,450,000 shares were sold under a separate prospectus in a secondary offering limited to Canada, in which defendant J. H. Crang & Co. of Toronto ("Crang"), was the underwriter. None of these shares was sold to Americans in Canada, and none was sold in the United States.

Finally, 3,950,000 shares were sold in another secondary offering, under a separate prospectus, in which defendant Investors Overseas Bank of Nassau ("IOB"), an IOS subsidiary, was the underwriter. This separate offering by IOB, limited to approximately 25,000 persons, was designed solely for sales to IOS employees and other IOS insiders, and sales thereunder were made almost exclusively to non-resident aliens in Europe, Asia, Australia, Africa and South America. Sales under this offering could also be made to United States citizens who were also IOS employees or other insiders, if non-residents of the United States, as authorized by an SEC order entered May 23, 1967. 386 Americans bought as IOS employees or insiders, at least 374 of whom were non-residents who bought outside the United States.

Since the three offerings were of shares of a foreign corporation effected entirely outside the United States, with sales limited to non-resident aliens (except for such limited exception under the IOB prospectus), the offerings were not registered under the 1933 Act. The facts as to all three offerings were presented in advance to the SEC, which took no action to prevent sales because of such non-registration.

Plaintiff, as an IOS employee and insider, is one of 386 Americans who bought IOS stock. He appears, however, to be the only resident citizen who bought, though he claims there are 11 others. He bought in violation of the SEC order of May 23, 1967 as to which he conceded prior knowledge.* He therefore bought with knowledge that, if a United States resident, he was barred from buying.

Nevertheless, on September 3, 1969, plaintiff wrote directly to the IOS office in Geneva, subscribing for 600

* See Interrogatory 23(b) (34A) and the answer thereto (44A).

shares, and enclosing a cashier's check in payment. Presumably the sale was made without apparent realization that plaintiff was not qualified to buy, and he in effect "bootlegged" his 600 shares into the United States. The sale appears to have been made directly by IOS and not by the underwriter IOB under the IOB prospectus which issued three weeks after the sale.

The complaint alleges violations of three provisions of the 1933 Act and three of the 1934 Act, including violation of Section 12 of the 1933 Act for selling securities for which a registration statement is not in effect under Section 5, and violation of the anti-fraud provisions of both the 1933 and 1934 Acts (5A). The District Court describes the complaint as alleging that the prospectuses "were false and misleading in that they failed to reveal material facts concerning I.O.S.'s finances, illegal activities, chaotic bookkeeping, and mismanagement, and the actual looting and plundering of I.O.S.'s treasury" (252A).

The complaint further alleges that plaintiff is suing individually and on behalf of all persons who purchased IOS stock under the public offerings, and that "Class members are estimated to approximate 100,000 persons" (6A). The class plaintiff thus claims to represent falls into at least three categories: (1) plaintiff alone, or possibly 11 resident Americans like plaintiff, who are IOS directors, officers, employees or other insiders who bought stock contrary to the SEC order and who also may, in effect, have "bootlegged" their stock into the United States; (2) some 374 non-resident Americans who bought outside the United States under the insider IOB prospectus, as authorized by the SEC order; and (3) some 99,614 non-resident aliens, scattered in a large number of foreign countries in Europe, Africa, Asia, Australia and South America, who bought outside the United States. This category of non-resident aliens constitutes over 99.6% of the class plaintiff purports to represent.

The complaint names as defendants, in addition to the eight above named underwriters under the three separate

offerings, defendant-appellant Arthur Andersen & Co. ("Andersen"), described by the District Court as "an international accounting firm," which had expressed its opinion as to the IOS financial statements as of December 31, 1968 contained in each of the three prospectuses; IOS, now in the hands of a Canadian liquidator, and Bernard Cornfeld, former president of IOS.

The Course of Proceedings Below

On April 7, 1972, plaintiff moved before Judge Frankel for a Rule 23(c) order "declaring that this action can be maintained as a class suit" (48A). All defendants urged denial, primarily because members of the proposed class have no claims under the federal securities laws.

On June 28, 1972, Judge Frankel ruled, "but only for the preliminary purposes at hand" (81A), that the case might "proceed for the time being as a class action" (82A), but left this question "open for re-examination under Rule 23(c)(1)" (84A) after "extensive discovery" (81A).

Judge Frankel also left "for later determination, upon a fuller record, the question whether foreign purchasers will be entitled to invoke the protections and sanctions of the American securities laws" (83A). Since the case was soon to be assigned to a single judge for all purposes, Judge Frankel felt that such basic jurisdictional issues should be decided by such assigned judge (84A).

Although Rule 23(c)(2) requires the Court to "direct to the members of the class the best notice practicable under the circumstances", no notice was ever sent. Plaintiff's counsel simply proceeded with the "extensive discovery".

By order dated December 27, 1972 and entered on consent, it was agreed to limit plaintiff's discovery to the issues of subject matter jurisdiction, personal jurisdiction and inclusion of foreign purchasers in plaintiff's class (85A-92A).

Since plaintiff was seeking extraterritorial application of the federal securities laws to three separate foreign offerings of a foreign corporation, his discovery effort was focused at coming under *Leasco Data Processing Equipment Corp.* v. *Maxwell,* 468 F.2d 1326 (2d Cir. 1972),—where this Court stressed meetings in New York,—by concentrating on every meeting or communication held in the United States, by anyone connected with the offerings, and on obtaining every letter, memorandum or document which might show some act of any nature in the United States, hopeful of finding something comparable to *Leasco* on which he could rely as a misrepresentation made in the United States.*

Then, with such discovery complete, all defendants, including Andersen, moved on October 31, 1973 to dismiss for lack of subject matter jurisdiction or, in the alternative, to exclude from the proposed class the 99,614 non-resident aliens who bought outside the United States (107A, 110A, 150A, 159A). The case was reassigned to Judge Carter (253A).

On June 28, 1974, at a time when these threshold motions made October 31, 1973, were still pending without having even been argued, the Drexel Group presented to Judge Carter a proposed order and stipulation of partial settlement (254A). Under such proposal, the Drexel Group purported to settle the $110,000,000 claim in behalf of the class of 100,000 shareholders for $700,000, to which plaintiff's counsel had agreed, with an indicated fee to him of $200,000.

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* Plaintiff's counsel has himself described the comprehensiveness and thoroughness of his discovery. In a brief to this Court, dated December 23, 1974, opposing leave to appeal under §1292(b), plaintiff's counsel referred to "the extensive pre-trial discovery material"; stated that there were "thousands of pages of exhibits and depositions"; and argued that though this initial wave of "discovery was limited to" such jurisdictional and class action issues, his discovery was so searching that "the case has been substantially prepared for trial and very little discovery remains",—even with respect to the merits (Br., pp. 9-10).

Objection was made by Andersen and other defendants to the proposed order as to settlement, on the ground, *inter alia*, that there had never been a hearing or decision on the issues of subject matter jurisdiction, or of whether plaintiff could represent a class of foreign purchasers, and that the District Court could not bind the 100,000 class members to a settlement if it lacked subject matter jurisdiction, or otherwise had no power to bind non-resident aliens to a judgment. Concurring in this position, Judge Carter, on July 15, 1974, advised counsel that he would:

> "first determine whether subject matter jurisdiction was present, advise the parties orally of its decision so that a notice of settlement could be perfected and distributed, and thereafter the court would file a written opinion explaining its holding" (254A).

Disposition in the Court Below

The motions made October 31, 1973 to dismiss for lack of subject matter jurisdiction or, in the alternative, to exclude from the proposed class the 99,614 non-resident aliens who bought outside the United States, were decided by Judge Carter on July 29, 1974, without his having set the motions down for oral argument. His chambers notified counsel orally that the court had found subject matter jurisdiction and would approve notice of partial settlement and set a hearing on the settlement (254A). Later, Judge Carter agreed to delay action on the proposed settlement until his written opinion was prepared.

On November 27, 1974, Judge Carter filed his written opinion explaining his reasons for subject matter jurisdiction (252A-280A). While such opinion will subsequently be considered under the "Argument" section, essentially, Judge Carter concluded that he had subject matter jurisdiction because the three separate prospectuses should be integrated as one offering (256A),—which he called his "integrated offering thesis" (259A, fn.2),—and because there had been "significant conduct" in the United States by various representatives of Drexel, Smith, Barney and

Price Waterhouse, accountants specially retained by Drexel as its accounting advisor, "which influenced and shaped the entire underwriting and offering" (268A). However, he recognized that "much of the work performed at that time was preliminary research undertaken by Drexel prior to firmly committing itself" (264-5A); and that "Obviously, many of the documented occurrences, taken by themselves, are of minimal significance" (267A).

Judge Carter also found that "subject matter jurisdiction exists" by "application of the principles espoused in *Leasco* and *Schoenbaum*"* (263A). He relied on *Leasco*, remarking that "in the instant case the ultimate representations or inducements do not appear to have occurred in the United States, as was true in *Leasco*" (268A), and he relied on *Schoenbaum*, though, unlike *Schoenbaum*, the IOS stock was not traded on a national exchange in the United States.

Subsequently, on December 4, 1974, Judge Carter made an order approving a notice which was in effect both a notice of a class action determination under Rule 23(c)(3) and a notice of compromise under Rule 23(e).** Such notice advised the 100,000 members of the class that they could opt out by March 6, 1975, and that "any judgment in this action, whether or not favorable to the plaintiff class, will include all members who do not request exclusion from the class and will be binding upon all class members who do not so request exclusion" (304A).

Statement of the Facts Relevant to the Issues Presented for Review

Judge Carter found subject matter jurisdiction by first integrating the three separate offerings into "a unified transaction for purposes of subject matter jurisdiction

* *Schoenbaum* v. *Firstbrook*, 405 F.2d 200 (2d Cir. 1968), *cert. den.* 395 U.S. 906 (1969).

** This Court, by order made December 19, 1974, stayed Judge Carter's order and the proposed mailing of the notice.

considerations'' (256A), though he recognized the three offerings as separate for purposes of *in personam* jurisdiction over Crang (271A-273A). Then, based on certain preliminary activity in the United States by Drexel, Smith, Barney, their lawyers and accountants, Price Waterhouse, as to the Drexel offering, Judge Carter found subject matter jurisdiction as to all three offerings, and also as to Andersen.

Judge Carter's opinion ignores the substantial and time-consuming work performed in Europe by underwriters,—which may be conservatively estimated at over 90% of the total work involved in the offering,—other than an erroneous statement that the work abroad constituted merely ''formal or ultimate acts * * * staged in Europe—e.g., the drafting of the final prospectuses and signing of agreements'' (267A). His opinion also ignores the fact that all Andersen's work, with one or two *de minimis* exceptions, was performed abroad.

Accordingly, there will be compared the preliminary activity in the United States as to the Drexel primary offering with the substantial and definitive work in Europe. The two secondary offerings and Andersen's activity will be separately considered.

The IOS Stock

IOS was originally incorporated as a Panamanian corporation in 1960 and reconstituted as a Canadian corporation in June 1969, following which it maintained a registered office in Montreal. Its principal executive office was located in Geneva. It was the parent company of an international sales and financial service organization, principally engaged in the sale and management of mutual funds and complementary financial services (56A).

IOS had no office in the United States, and did not transact any business in the United States, though an affiliate owned a tract of land in Florida (73A, 204-205A).

On May 23, 1967, IOS and its affiliates were forbidden by SEC order from engaging in any activity subject to its jurisdiction, and were barred from making sales of securities to United States citizens or nationals wherever located, except for sales outside the United States "to officers, directors and full-time personnel of IOS and its subsidiaries" (192A-113, ¶4(i)). Accordingly, at the time of the three offerings, IOS and its affiliates were not engaged in the sale of mutual funds or other securities in the United States, or in any other activity subject to the SEC's jurisdiction (56A-57A).

IOS stock has never been listed on a stock exchange in the United States or traded over the counter. Before the September 1969 offerings, there was no market for IOS stock anywhere, and there has never been a market in the United States for IOS stock (60A).

The Primary Offering by Drexel

The 5,600,000 newly-issued IOS common shares in the Drexel primary offering were underwritten and sold only to non-resident aliens in Europe, Japan and Australia. The evidence overwhelmingly established, and Judge Carter ruled, that none of the 5,600,000 shares of IOS stock in the Drexel primary offering had been sold in the United States or had been sold to any United States citizen anywhere in the world (268A). He said they were "sold in Europe to Europeans" (256A), overlooking sales in Asia and Australia to nationals of those two continents (175A).

The offering was not registered under the Securities Act of 1933. And, the SEC, to which all the facts had been presented several months before the offering (194A-195A; 209A-213A) took no action to prevent the sale and has never asserted any claim of alleged violation of the federal securities laws.

The SEC has never taken the position that the federal securities laws apply to offerings of shares of a foreign

corporation, made outside the United States. Because of its traditional view that the securities laws are intended to protect American investors, the SEC does not require registration of offerings by a United States corporation to non-resident aliens.

SEC Release No. 33-4708 and No. 34-7366, dated July 9, 1964, 29 Fed. Reg. 9828 (1964)* which deals with foreign offerings by domestic issuers, makes clear that registration is not required for offerings made by a United States corporation to foreign investors:

> "The Commission has traditionally taken the position that the registration requirements of Section 5 of the Act *are primarily intended to protect American investors.*"**

Accordingly, the foreign nature of the offering, and its exemption from registration is not affected by

> "whether the offering originates from within or outside the United States, whether domestic or foreign brokerage dealers are involved, and whether the actual mechanics of the distribution are effected within the United States, *so long as the offering is made under circumstances reasonably designed to preclude distribution or redistribution of the securities within, or to nationals of, the United States.*"

The six underwriters in the Drexel Group, and Crang and IOB each separately concluded that if they followed the SEC Release as to foreign offerings by domestic issuers, —though theirs were foreign offerings by a foreign issuer, —there could be no question of possible violation of the American securities laws.

This SEC Release has two aspects, namely, the activity by the underwriters within the United States and the steps

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* In accordance with Rule 28(f), F.R.A.P., such SEC Release is reproduced as an addendum at the end of this brief.

** Unless otherwise noted, all italics have been supplied.

to preclude sale within the United States or to United States nationals.

Judge Carter focused on meetings in New York, of a preliminary and exploratory nature, which "taken by themselves, are of minimal significance" (267A), but found the totality sufficient for subject matter jurisdiction. These need not be here set forth since they are so meticulously detailed in Judge Carter's opinion (263A-267A).

However, though the SEC, in a foreign offering of shares of a domestic issuer, sanctions having "the actual mechanics of the distribution * * * effected within the United States," the Drexel Group, because IOS was Geneva-based and its records were all located there, performed substantially all the work abroad.

The affidavits of Bertram D. Coleman, Chairman of Drexel's Executive Committee (the "Coleman affidavit") (55A-60A); of George P. Bischof, Vice President (Corporate Finance) of defendant Smith, Barney (the "Bischof affidavit") (113A-119A); and of Jerome Istel, manager of defendant Banque Rothschild (the "Istel affidavit") (120A-124A) describe the scope and extent of the work performed abroad.

Plaintiff's "extensive discovery" was limited to acts in the United States and there is nothing in this voluminous record which contradicts the statements in the Coleman, Bischof and Istel affidavits. However, though such affidavits were uncontradicted, they were ignored in Judge Carter's opinion, which failed to evaluate the activity abroad described in such affidavits as compared with the "occurrences * * * of minimal significance" (267A) in the United States to arrive at a balanced picture.

Once Drexel and Smith, Barney decided to participate in the Drexel offering, little, if any, of even the most mechanical aspects were done in New York. The persons involved simply moved to Geneva, where they spent all their time for three months working on the underwriting.

The affidavits of Coleman (57A) of Drexel, and of Bischof (117A-118A) of Smith Barney, state in detail the extensive work performed abroad, in reviewing and revising the prospectus and setting-up the underwriting syndicate.

The syndication of the underwriting was accomplished exclusively in Europe. There were 122 underwriters, 96 of which were located outside the United States, with the greatest number in the United Kingdom, France, Germany, the Netherlands, Luxembourg and Norway, and with others in Japan and Australia (57A, 175A-176A). No United States firm was permitted to serve as an underwriter unless it had an office outside the United States, Canada and Mexico from which it could conduct all its activities connected with the Drexel offering (57A-58A).

Of the six representatives of the underwriters in the Drexel offering, Drexel and Smith, Barney were the only United States firms, and they conducted all their solicitation and selling activities through offices in Brussels and Paris (58A). The other four representatives in the Drexel Group were in the United Kingdom, France, and the Netherlands (58A).

The underwriting agreement with IOS was concluded in London; the Agreement Among Underwriters was concluded in Brussels; the Drexel prospectus was prepared in London and Brussels; and the offering was closed in London (58A).

The Drexel prospectus was prepared in three languages, English, French and German. The English versions of the preliminary and final prospectuses were printed and proofed in London; the French versions in Switzerland; and the German versions in West Berlin (57A).

The preliminary and final prospectuses were distributed from London and Brussels solely to underwriters and dealers with offices outside the United States, Canada and Mexico. No prospectuses for the primary offering were

sent by any member of the Drexel Group to any address in the United States, Canada or Mexico (57A).

Delivery of the IOS stock to the underwriters and dealers involved in the Drexel offering and payment by the underwriters and dealers all took place in London (118A-119A).

As noted from the SEC Release exempting foreign offerings by domestic issuers, the SEC does not require an iron-clad guaranty that no American within the United States will ever somehow manage to acquire stock in the offering. The sole test is whether the offering, as structured, is "reasonably designed to preclude distribution" in the United States or to American citizens anywhere. Accordingly, there will be set forth the steps taken to preclude unauthorized distribution.

The Drexel prospectus, under the heading "UNDERWRITING", lists 122 underwriters in 14 countries, in Europe, Japan and Australia, in which such underwriters were located, and where they intended to sell IOS stock (175A-176A). While some of such underwriters were from the United States, their solicitation and selling activities were confined to offices outside the United States in accordance with their agreement to maintain the entire offering as a foreign one (57A-58A).

The 122 underwriters and dealers who purchased the IOS common shares for resale were strictly bound by contractual provisions summarized in a legend on the front page of the Drexel Group prospectus, which categorically stated that the common shares offered by the prospectus were not registered, and set forth the restrictions against sale within the United States, or to United States citizens outside the United States.

Before the closing, each of the 122 underwriters and dealers represented in writing, as a condition to its receipt of the offered securities, that none of the IOS shares sold by it and none of the shares sold by dealers to whom it

sold shares, had been sold contrary to such restrictions, to which each participant had specifically agreed (58A-59A).

Finally, an additional and very effective deterrent to purchases by a United States person was the ruling obtained from the Internal Revenue Service that acquisition of IOS shares by a United States person would be subject to the United States interest equalization tax,—an opinion disclosed in the prospectus (59A).

The Coleman affidavit, without contradiction, describes such safeguards to preclude unauthorized sales as "the most stringent ever taken in any European securities offering" (58A). These stringent restrictions were fully complied with by every underwriter and dealer who took part in the offering (59A).

The District Court found that "no sales to Americans did occur" through the Drexel offering (268A).

The Secondary Offering by Crang

There were offered in Canada 1,450,000 previously issued IOS shares, underwritten by Canadian firms managed by defendant Crang. The affidavit of Murray J. Howe, president of Crang, shows that there was no activity in behalf of Crang in the United States, and also describes the rigid restrictions taken with respect to the Crang offering to insure that sales were restricted to Canada and that no sales would be made to American citizens (63A-71A).

The Crang prospectus was drafted partly in Geneva and partly in Canada, and was especially adapted to comply with all the requirements of Canadian securities laws and regulations (67A-68A). Each of the ten provincial securities commissions in Canada, as well as the Canadian Federal Securities Commission, reviewed and cleared the Crang prospectus in its initial and final forms (69A). After detailed questions were posed by the Canadian commissioners and answered by Crang, the Crang prospectus

was changed to comply with all applicable Canadian regulatory interpretations (69A). Also, Crang had been informed by the several Canadian commissions that their regulatory jurisdiction was exclusive. The Crang prospectus was printed in Canada and distributed from Toronto to members of the banking group in various locations in Canada (70A).

It is not necessary to particularize the relative insignificance of Crang's activity in the United States as compared with its activity in Canada. For Crang's acts within the United States were described by Judge Carter as "*de minimis* preliminary discussions" (273A),—language equally applicable to the Drexel Group. Judge Carter also found that "The evidence reveals that Crang investigated I.O.S.'s affairs and prepared the prospectus in Canada, Switzerland and France" (273A).

Again, rigid precautions were taken to prevent sales in the United States or to Americans, and such agreements were strictly adhered to (240A).

Thus, Judge Carter found that Crang "accepted orders for I.O.S. stock in Toronto and sold shares only outside the United States and only to non-Americans" (273A). Judge Carter also found that "Crang did not sell I.O.S. shares to any American citizen, took precautions to prevent and placed restrictions on the sales to Americans, and understood that all other parties to the offering would observe similar restrictions" (274A).

The Secondary Offering by IOB

The third offering, which was of 3,950,000 common shares, also made clear that it was not being offered in the United States, and also complied with the "reasonably designed to preclude" criteria.

The affidavit of Kenneth L. Beaugrand, a director of IOB, noted the distinction between the IOB offering and

the Drexel and Crang offerings, stressing, what is manifest from the prospectus itself and is uncontradicted, that "unlike the other two offerings, the IOB Offering was made to a limited number of narrowly defined purchasers" (77A), namely, IOS directors, officers, employees and other IOS insiders, and set forth the measures taken by IOB to assure compliance with all restrictions on sale (75A-80A).

The IOB prospectus states on its face (184A):

> "The Common Shares offered by this prospectus are not registered under the United States Securities Act of 1933 and are not being offered in the United States of America or any of its territories or possessions or any areas subject to its jurisdiction (the 'United States') or in Canada or Mexico.
>
> * * *
>
> "This offering is being made to approximately 25,000 persons who are either (1) employees or sales associates of the Company, (2) certain clients presently holding investments in managed funds or other products of the Company, or (3) persons who have had a long-standing professional or business relationship with the Company."

All of the foregoing, as above noted (p. 11), was expressly authorized by the SEC order of May 23, 1967 (192A-109).

While Judge Carter found that 386 American citizens bought under the IOB offering,—recognizing that they were either IOS employees or other insiders (256A),—he made no effort to distinguish between resident and non-resident Americans. As noted below, plaintiff may in fact be the only resident American who bought IOS stock, and even he does not suggest that there were more than 11,—four of whom were, at the same time, also sellers of IOS stock (see pp. 20-22, *infra*).

The Purchase of IOS Stock by Plaintiff With Knowledge That He Was Violating the SEC Order and Illegally "Bootlegging" Stock

Plaintiff bought 600 shares for $6,000. Plaintiff worked directly under Robert Sutner, an IOS director and senior advisor to its sales organization (172A). As an insider, he apparently learned of the public offering and on September 3, 1969,—21 days before the date of any of the three prospectuses,—wrote Juanita C. Torres, 119 Rue d'Lausanne, Geneva, an IOS employee, and subscribed for 600 shares at $10 a share, enclosing a cashier's check in payment (47A-1).

Juanita C. Torres was an IOS employee who also bought stock for herself (234A-1), and must therefore have been familiar with the IOS subscription form for IOS employees which she received from plaintiff and which presumably she herself had to complete for her own stock. She accepted plaintiff's subscription and check, either without realizing that resident American IOS employees were not authorized to buy or perhaps without noticing that plaintiff gave a New York address on his subscription form.

Plaintiff did not buy under the Drexel or Crang prospectus, since as Judge Carter found, "no sales to Americans did occur through the Drexel Group or Crang offerings" (268A). Judge Carter stated that "Sales through the I.O.B. Offering have been documented to approximately 386 Americans, one among them being plaintiff Bersch" (268A-269A). However, it is not clear from the documents that plaintiff bought under the IOB prospectus, since he bought on September 3, 1969, by direct subscription to IOS, in Geneva, whereas the IOB prospectus was dated September 24, 1969, three weeks later, in the Bahamas.

Judge Carter found that "plaintiff's purchase of I.O.S. shares does not appear to have been made in reliance on

statements in the Crang prospectus, since that prospectus was sent to the United States after the date of the purchase" (273A). Such non-reliance would necessarily apply to all three prospectuses, all dated three weeks after plaintiff's purchase.

Plaintiff nevertheless claims prior reliance on all three prospectuses. His answers to interrogatories, sworn to February 1, 1972, state (46A):

> "*None of the prospectuses were mailed to my home.* One, I do not remember which, may have been mailed to me at my office. The others were available to me at my office" (Ans. 26).

This answer, which would not satisfy the jurisdictional requirement of use of the mails, was contradicted by plaintiff in his affidavit of May 12, 1972 (73A):

> "At our offices in New York were copies of the three prospectuses used in this offering. *One was mailed to my home in New York.* I read all three prospectuses."

As already noted, plaintiff conceded in his Answers to Interrogatories (Ans. to No. 23(b)) that when he bought on September 3, 1969, he was "aware of a consent order regarding I.O.S., Ltd. entered by the Securities and Exchange Commission on May 23, 1967" (34A, 44A). Accordingly, in initiating his purchase by sending in his subscription form and check, plaintiff was in effect "bootlegging" his stock into the United States and entrapping an IOS clerk into accepting his subscription, though knowing he was barred from buying.

A fact which may bear significantly on plaintiff's position in this case is whether he is the only resident American who bought IOS stock, and if not, the number of others. Plaintiff's affidavit sworn to May 12, 1972, states (73A):

> "I was not the only American residing here who purchased IOS stock. * * * Among the New Yorkers

> purchasing the IOS securities were: Christine Cullen, Nadyne Nelson, Claire Pipolo, David Ellner, *Elliott Adler*, Robin Leach, *Robert Sutner*, Raymond Grant, Simme Arthur, *Hyman Feld* and *Morton Schiowitz.*"

His affidavit vaguely suggests that Americans in Florida, also IOS insiders, may have also bought stock (73A).

However, plaintiff provides no basis for such statements and merely makes the flat hearsay assertion that these 11 named buyers were American residents, without stating that he has personal knowledge. Nor does plaintiff state whether, like himself, these 11 other alleged purchasers also subscribed three weeks before the IOS offerings were made, by a direct communication to IOS' Geneva office, and therefore also could not have relied on the prospectuses.

Then, to bolster his position and perhaps make an additional argument for subject matter jurisdiction, based on there being American *sellers*, plaintiff's affidavit also states (74A):

> "*On my own personal knowledge*, I know that the following persons who sold IOS stock through the secondary offering were resident Americans: *Robert Sutner, Elliott Adler, Morton Schiowitz*, Philip Gordis, Lester Hayes, *Hyman Feld*, Howard Stamer and Robert Haft."

The four persons whose names are italicized,—Robert Sutner, Elliott Adler, Morton Schiowitz, and Hyman Feld, —are also named in plaintiff's hearsay list of 11 alleged resident American *buyers*, as well as in his "personal knowledge" list of American *sellers*. Clearly, if these four were selling stock under an allegedly false prospectus and in turn were also buying in reliance on such prospectus, they cannot complain of the misrepresentations and cannot sue, with plaintiff as their representative.

In the course of plaintiff's extensive discovery, he did not elicit anything to support his hearsay statement as to

such alleged 11 American resident buyers of IOS stock out of the 100,000 purchasers. From all that appears from plaintiff's "extensive pre-trial discovery" and "thousands of pages of exhibits and depositions" he may be the only resident American who bought IOS stock.

However, whether plaintiff is the only resident American who bought or whether there were these 11* other resident American buyers, as he claims (four being also sellers), clearly could not affect the issues of subject matter jurisdiction and judicial jurisdiction over non-resident aliens involved in this appeal.

The Role of Defendant Arthur Andersen & Co. in the Three Offerings

Andersen, as Judge Carter stated, is an "international accounting firm" with offices in various parts of the world. It served as IOS' independent public accountants for some ten years, examining its annual consolidated balance sheet and related statements of consolidated income and retained earnings (101A).

Andersen's IOS auditing work was done by its Swiss office in Zurich. Under dateline "Zurich, Switzerland, April 15, 1969," Andersen rendered its report for 1968, which merely stated that it had "examined" certain financial statements and gave its opinion that the statements

* By letter dated December 15, 1970, IOS counsel supplied the SEC with a list of 360 Americans known to have purchased IOS common shares, giving "their last known addresses, the number of shares acquired by each, and the relationship each individual had with one or more companies in the I.O.S. group at the time of the public offerings" (228A-1).

Each of the 360 Americans on this list was an IOS employee; 350 lived abroad and a number gave addresses in the United States,—usually in care of someone, which would indicate that they may have resided abroad. In the case of others, they had United States addresses, which could be accounted for by the fact that after the collapse of IOS, some nine months previously, they left their positions abroad and returned to the United States. The fact that their "last known addresses" in December 1970 were domestic would not, of course, indicate that they also had a domestic address in September 1969, when the offering was made.

were "in conformity with generally accepted accounting principles" (179A).

When such opinion was last rendered on April 15, 1969, as to 1968, the public offerings were not yet even contemplated. Andersen merely followed its practice of expressing an opinion on IOS' financial statements for the prior calendar year. However, after IOS decided on the public offerings, Andersen consented on September 24, 1969, also under the Zurich dateline, "to the use of our reports and to all references to our firm included in or made part of this prospectus" (178A).

In dismissing as to Crang, Judge Carter noted that Crang "took precautions to prevent and placed restrictions on the sales to Americans, and understood that all other parties to the offering would observe similar restrictions" (274A). Similarly, when Andersen consented to such use in the prospectuses of its reports and references to its firm, it knew of the restrictions on sale to Americans and understood that such restrictions bound everyone involved in the three offerings (102A-103A).

Furthermore, Andersen was informed of the SEC order of May 23, 1967 prohibiting IOS and its affiliates from engaging in any activity subject to SEC's jurisdiction, and barring IOS from sales in the United States or to United States citizens or nationals, wherever located, except for non-resident IOS directors, officers, employees and insiders (103A).

The complaint's principal allegation against Andersen is that since the offering was made in September 1969 and the financial statements examined and reported upon by it "spoke as of the year ended December 31, 1968 * * * Andersen knew or should have known that its certified statements were not current and should not be used in connection with the IOS Public Offering" (¶14(d) (15A)).

Actually, the underwriters asked Andersen to perform an audit as of June 30, 1969,—known as the "stub period",

—but Andersen advised that, unless the target date of the offering, September 1969, was extended, there was insufficient time for completion of an audit. Such "stub period" was covered in the three prospectuses by unaudited financial statements furnished by IOS. This would conform with SEC requirements as to currency of financial statements, even though such requirements were inapplicable because of the foreign character of the three offerings.

Plaintiff's memorandum of law on class action status and jurisdiction, received April 8, 1974, claims that the underwriters, IOS and Bernard Cornfeld are the primary wrongdoers, and that Andersen is "an aider and abettor" (p. 60).

While Judge Carter based subject matter jurisdiction on preliminary meetings and other activity in the United States involving members of the Drexel Group, none of such occurrences involved Andersen. Judge Carter found subject matter jurisdiction against Andersen on a dragnet basis by assuming that if the Drexel Group's activity in the United States created subject matter jurisdiction, there was automatically subject matter jurisdiction as to Andersen. Inconsistently, he did not apply such dragnet approach to Crang, as to which he found *in personam* jurisdiction lacking (275A). His opinion does not consider, and shows no apparent realization, that Andersen had no relationship to the underwriters or their New York meetings, and was simply a European office of an international accounting firm performing its annual service as independent auditors of IOS, of expressing its opinion on IOS' financial statements before the three public offerings were even contemplated.

Andersen's role has a posture in this foreign offering separate from that of the underwriters, with their alleged activity in New York. Thus, unlike the two American underwriters, who had been selected solely for the public distribution of IOS stock in the September 1969 offerings, Andersen's Zurich office had, as already noted, for almost 10 years been independent public accountants to IOS and

its audit of the December 31, 1968 financial statements had been concluded before any of the three offerings was even contemplated. Accordingly, IOS did not select "an American accounting firm" for its public offerings (82A), but simply used existing work of the international accounting firm with which it had had a long-standing relationship.

Andersen's audit was performed in Switzerland, France and England, under the direction of Walter Tenz, a Swiss citizen, who resided in Milan (98A). As testified by Wilbur S. Duncan, a partner in Andersen's New York office, Tenz, a partner in Andersen's Zurich office, had ultimate responsibility for the audit (93A-12, 93A-13).

Walter W. Ruegger, a partner in Andersen's New York office, reinforced Duncan's testimony (93A-19):

> "The financial statements in that prospectus were covered by our Zurich office. People in the Zurich office and our resident staff in Geneva performed the bulk of practically all of the audit work behind all this."

Plaintiff's counsel, seeking to establish that Andersen had performed some significant or substantial work in the United States, in his effort to assert jurisdiction over it, pressed Ruegger for anyone from the New York office who had any conceivable involvement in the audit (93A-19), only to elicit testimony that no one connected with the Andersen office in New York was "involved in any way with any of the preparations of the I.O.S. financials that are contained in the Drexel prospectus" (208A-86). The same financial statements were included in all three prospectuses.

Thus, while Judge Carter stated broadly, without identifying the defendants to which his statement referred, that "the acts abroad were substantially supervised from New York" (267A), this is not true as to Andersen, which performed all its work abroad with no supervision or direction from its New York office.

Since, as the uncontradicted evidence shows, all Andersen's work was done in Europe, its workpapers evidencing the audit and the substantive adjustments were all in Europe (105A; aff. ¶10).

Since IOS had its principal office and operations in Europe, where the audits were performed (104A), Andersen applied transnational reporting and accounting principles, as well as generally accepted accounting principles (93A-15), so that it is particularly inappropriate for its conduct to be regulated solely by United States securities laws, as plaintiff's counsel states.

Plaintiff's "extensive discovery" revealed that Andersen merely attended one meeting in New York, with Drexel, on July 11, 1969 (93A-10-11). There, Tenz simply explained the decision made in the Geneva office that a proper audit of IOS as of June 30, 1969 could not be made in time for a September offering (93A-13-14).

Andersen was represented at this meeting by Tenz and Matthew Tiffert, both from Geneva. Since the meeting was in New York, Tenz and Tiffert were accompanied by two Andersen representatives from the New York office, Duncan and Ruegger. This was normal protocol for a meeting held in their bailiwick, especially since Tenz and Tiffert had come from abroad. Therefore, the presence of Duncan and Ruegger during part of the meeting does not show participation by Andersen's New York office in the underwriting or establish subject matter jurisdiction as to Andersen. Ruegger left the meeting long before it concluded (93A-20).

Yet, a primary basis for the District Court's assertion of jurisdiction over Andersen is its attendance at such July 11, 1969 meeting in New York, at which IOS, Drexel, Price Waterhouse and Shearman & Sterling were present, and at which there was "discussed the need for an audit or partial audit in connection with the offering planned for September", and "Arthur Andersen's work in connection with the June 30, 1969 financials of I.O.S. was mentioned" (265A).

As auditors to Fund of Funds, Limited ("Fund of Funds"), a mutual fund managed by IOS, Andersen con-

firmed assets of Fund of Funds Proprietary, Limited ("FOF Proprietary"), a subsidiary of Fund of Funds, by performing standard auditing procedures, such as counting securities held by FOF Proprietary or confirming them with the custodian (93A-17).* Ruegger made it clear, however, that the information generated from his audit work relative to Fund of Funds was not used in connection with the IOS financial statements in the Drexel prospectus, since the "funds are not part of the IOS financial statement" (93A-22).

Andersen's field work relative to FOF Proprietary was the usual "inter-office referral" from Geneva to Andersen's New York office (104A, aff. ¶7). At the conclusion of such work, the audit evidence and workpapers were sent to Geneva (93A-18), where the substantive work was done (105A, aff. ¶10).

In short, Andersen's relatively insignificant ministerial work in the United States, even with respect to FOF Proprietary (not IOS), was as *de minimis* as that of Crang (273A) and was all done under Geneva control, as an incident of the substantive work done in Geneva. And, none of Andersen's work abroad was directed or supervised by its New York office.

As already noted (pp. 12-13, *supra*), were this a foreign offering of shares of an American corporation, rather than a foreign offering of shares of a foreign corporation, the foreign nature of the offering would not be affected by the fact that "the actual mechanics of the distribution are effected within the United States". Then, *a fortiori*, Andersen should not be subject to American securities laws as to these three foreign offerings because of attendance at one meeting in New York to explain why there wasn't time to make an audit as of June 30, 1969, and the other straws at which plaintiff's counsel has grasped to find subject-matter jurisdiction as to Andersen.

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* Both Fund of Funds and FOF Proprietary were headquartered in Europe. A New York broker, however, Arthur Lipper Corporation, performed the record-keeping function for FOF Proprietary which held the bulk of the assets of Fund of Funds (93A-16-22).

Plaintiff's counsel undoubtedly will, as he did below, rely heavily on a document listing 36 questions propounded to Andersen's Zurich office by Price Waterhouse, engaged by Drexel and not by Andersen, concerning certain of the IOS managed funds, as at June 30, 1969 (215A-219A). Plaintiff's counsel tried to make it appear that Price Waterhouse had somehow found fault with Andersen's audit work,—a factor irrelevant to the issue of subject matter jurisdiction or the other jurisdictional and class action issues raised by this appeal. These questions were referred to in Judge Carter's opinion. In finding subject matter jurisdiction, he relied on a meeting in New York, which "After returning from work in Europe", Price Waterhouse officials had with members of Shearman & Sterling and Drexel to discuss a Price Waterhouse report which "included questions about practices engaged in by I.O.S., and Arthur Andersen's financial report on the company" (265A),—a meeting not attended by Andersen.

However, these questions were raised by Price Waterhouse simply because Andersen did not undertake to make an audit for the "stub period" because of time limitations imposed by the underwriters over which Andersen had no control. Judge Carter referred to the discussion as to "the need for an early offering" (265A), which made it impossible for Andersen to make such an audit to meet the underwriters' target date.

Price Waterhouse, by reason of its work abroad, satisfied itself as to each of the 36 questions. Grayson Murphy of Shearman & Sterling, counsel for the Drexel underwriters, testified:

> "[T]hey [Drexel] retained Price Waterhouse to go over to Geneva and to make various investigations. There were a team of about six of them that went over and their function was to—particularly function on the stub period, that six-month period [ending June 30, 1969] we were talking about, and to come up with all the questions they could in regard to the financials,

in regard to the accounting procedures, so that Drexel people could satisfy themselves as to the extent they could on the accuracy of the stub period" (93A-1).

Murphy further testified that Drexel might not have continued with the offering "if the questions raised could not have been answered satisfactorily,"—but in fact "they felt that they got satisfactory answers" (93A-2).

Murphy's testimony was supplemented by Werblow, a Price Waterhouse partner, who testified that "special checking procedures" which Drexel wanted IOS to ask Andersen's Zurich office to carry out in connection with the June 30, 1969 unaudited financial statements "were prepared by a Price Waterhouse partner in Geneva and in Ferney-Voltaire" (93A-6).

Werblow further testified that there was extensive discussion with Andersen about the "special checking procedures" in Geneva, Ferney-Voltaire, and London (93A-7).

Andersen's Zurich office also prepared a report on the internal controls of IOS which was delivered to Werblow in Geneva, and discussed by Werblow in Geneva and other places in Europe (93A-8). Such office also delivered in Europe a "comfort" letter to the underwriters.

The SEC's Contact With the Three IOS Offerings

The full facts as to the three IOS offerings were furnished the SEC by letter of August 7, 1969, from Grayson Murphy of Shearman & Sterling, Drexel's attorneys. He there described the basic factors as to the Drexel offering and the measures to preclude sale in the United States or to United States persons abroad other than IOS insiders, and advised that similar restrictive measures would be taken by Crang and IOB (209A-213A).

Also, as Judge Carter stated, "Drexel officials and its counsel met with SEC officials to discuss the offering and problems the SEC had with I.O.S." (264A).

While the SEC did not issue a "no action" letter,—which is not issued in the case of foreign offerings of foreign corporations,—it responded on September 8, 1969 with a reminder that "the prohibition of the Commission's order of May 23, 1967 would be applicable" (214A).

In any event, the SEC, though fully apprised of the three IOS offerings, took no steps to apply the federal securities laws to any of them.

The fact that all aspects of the three IOS offerings were fully presented to the SEC, both by correspondence and personal conference, and that the SEC took no steps to apply the federal securities laws to any of them, would clearly indicate that the SEC deemed such laws inapplicable. Yet, rather anomalously, Judge Carter used this as additional proof to sustain subject matter jurisdiction, because such full disclosure to the SEC took place in the United States (264A).

After the IOS collapse, the SEC moved quickly to obtain full information as to sales to Americans, which was furnished by letters dated September 17, 1970 (226A-232A) and December 15, 1970 (228A-1). Though the SEC has had full knowledge of the sales to Americans for over four years, it has not asserted a claim of violation of the 1933 or 1934 Acts, or of the SEC order of May 23, 1967.

THE ARGUMENT

POINT I

The District Court lacks subject matter jurisdiction over the three IOS foreign offerings, since the American securities laws do not reach stock offerings of a foreign corporation, with no office in the United States; where the offerings are not made in the United States; where the stock is not listed on any exchange in the United States; where the stock was not traded in the United States, either before or after the offerings; and where there were rigid and effective restrictions against sales within the United States or to American citizens resident outside the United States, with certain exceptions authorized by the SEC.

A. The Alleged Jurisdictional Basis of the Cause of Action

Federal jurisdiction under the 1933 Act is here based on Section 12, since securities were sold without being registered; on Section 15, as to liability of controlling persons; on Section 17, the anti-fraud provision; and on Section 22, as to jurisdiction over violations.

Federal jurisdiction under the 1934 Act is based on Section 10(b) and Rule 10b-5; on Section 15(c)(1), as to brokers or dealers who use fraudulent devices; on Section 20, as to liabilities of controlling persons; and on Section 27, as to "exclusive jurisdiction" over violations of the 1934 Act.

Judge Carter, in sustaining subject-matter jurisdiction as to all three prospectuses, repeated *en passant* all the sections of both Acts relied on in the complaint's jurisdiction paragraph (252A), but nowhere cites the particular substantive section he believes applicable and violated. However, from the thrust of his opinion, he apparently relied for subject matter jurisdiction on Section 10(b) of the

1934 Act, though he also suggests jurisdiction because "some of plaintiff's claims arise under the Securities Act of 1933" (259A).

Judge Carter ignored the settled principle, restated in *Foley Bros., Inc.* v. *Filardo*, 336 U.S. 281, 285 (1949), "that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States". He also ignored this Court's *caveat* in *Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F.2d 963, 969 (2d Cir. 1969), *cert. denied*, 399 U.S. 909 (1970)) that "It is not the province of the courts to extend Section 10(b) to apply to transactions not intended to be covered by Congress."

Judge Frankel, though permitting the case to "proceed for the time being as a class action", indicated doubt as to subject matter jurisdiction (81A-82A):

> "It is not possible (or desirable) to say now with confidence whether the transactions plaintiff assails are reachable under either or both of the 1933 and 1934 Acts."

Weaver v. *United California Bank* (N.D. Cal., decided March 29, 1974) and unreported,* involved alleged misrepresentations made in connection with the sale of securities of a Swiss subsidiary of a California bank, with a class containing European investors. The Court there held:

> "First of all is the question of whether the Europeans are afforded the protection of the United States security legislation. Subject matter jurisdiction depends on 'use, indirectly or directly of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange.' 15 U.S.C. §78 j (b) and Rule 10b-5. See also 15 U.S.C. §78aa. None of these requirements are met here since it is clear from the record that the European members

* A true copy of the memorandum decision was presented to Judge Carter as Exhibit A to the affidavit of Leonard M. Marks, sworn to July 9, 1974 (Record, 137).

> lived in Europe, were solicited in Europe by offerings and prospectuses generated in Europe and in Europe, consummated their investment in this European Bank. Furthermore, there being no significant conduct of any kind within the United States by defendants as to the foreign plaintiffs, extraterritorial application of the securities laws would not protect domestic investors and domestic markets, and would thus be unwarranted."

There is nothing in either Act to show Congressional intent, in enacting the 1933 and 1934 Acts, to cover foreign offerings of foreign corporations, like those at bar. *Leasco* indicated an approach of ascertaining what Congress would have done had it thought about the point: "Still, we must ask ourselves whether, *if Congress had thought about the point*, it would not have wished" to extend protection of the American securities laws in certain areas (468 F.2d at 1337).

Clearly, "if Congress had thought about the point", it would not have intended to protect the 99,614 non-resident aliens who bought, paid for and received stock of a foreign corporation in so many foreign countries in Europe, Asia, Africa, Australia and South America. As stated in SEC Release No. 33-4708 and No. 34-7366, dated July 9, 1964, the 1933 Act's registration requirements "are primarily intended to protect American investors" (see p. 12, *supra*).

The SEC recently reaffirmed this as to a Rule 146 offering, which exempts from registration a private offering where there are "no more than thirty-five purchasers" (Rule 146(g)(1)). It ruled that, though there were many more than 35 purchasers, but not more than 35 citizen-resident purchasers, there was compliance with the 35-purchaser requirement. Since securities laws are for the protection of American investors, "it seems clear that non-resident alien purchasers should not be counted in determining the number of purchasers for purposes of Rule 146" (*Salt Cay Beaches Limited*, Sept. 12, 1974, Fed.Sec.L.Rep. (New SEC Rulings), ¶79,985, p. 84,532).

While this relates to registration,—which also prescribes the "quality of disclosure" (268A),—there is no reason to assume that "if Congress had thought about the point", it would have intended the 1934 Act's anti-fraud provisions to apply to a non-resident alien who bought, paid for and received his stock of a foreign corporation, in his native country, from a non-resident alien seller.

Finch v. *Marathon Securities Corp.*, 316 F.Supp. 1345, 1349 (S.D.N.Y. 1970), held that:

> "[A] district court is without subject matter jurisdiction over a cause of action alleging no domestic injury or consequence, brought by a British resident against other foreigners, for injuries sustained as a result of being fraudulently induced in a foreign country to purchase securities of an alien corporation."

"[I]f Congress had thought about the point", to what extent would it intend to cover sales by a foreign corporation, of its own stock sold by a wholly-owned foreign subsidiary, to non-resident American citizens, who were officers, directors, employees or other insiders of the issuing corporation? *Garner* v. *Pearson*, 374 F. Supp. 591, 598 (M.D. Fla. 1974) stated that:

> "Section 10(b) was not intended to impose rules of conduct on transactions occurring outside the United States when the only connection with the United States is the citizenship of the purchaser or seller."

SEC Release No. 33-4708, July 9, 1964, states that the 1933 Act would apply to "a public offering *specifically directed toward American Nationals abroad*, including servicemen". However, the IOB offering was not "specifically directed toward American Nationals"; it was specifically directed to IOS employees, a negligible portion of whom were Americans. The prospectus shows on its face that "This offering is being made to approximately 25,000 persons" who are IOS employees or other insiders (184A). And, as Judge Carter noted, only 386 were Americans (256A).

The SEC did not view its registration requirements as applicable to the IOB offering. When the facts were fully presented in advance to the SEC, it took no action, other than to remind of "the prohibitions of the Commission's order of May 23, 1967" (214A) which authorized sales to citizen IOS employees and other insiders if non-residents of the United States.

We also submit that "if Congress had thought about the point", it would not have intended the federal securities laws to apply to a *de minimis* offering of a foreign issuer, made to a resident American citizen insider, who bought three weeks before the offerings, knowing that an SEC order barred him from buying.

But if Congress intended to protect such a buyer, it would not have intended that protection for him could create subject matter jurisdiction over all three offerings, and sweep into the federal court sales made abroad to 99,614 non-resident aliens and to 374 non-resident Americans who were directors, officers, employees or other IOS insiders.

B. *Schoenbaum* and *Leasco* Do Not Compel the Conclusion That the District Court Has Jurisdiction Over the Three IOS Foreign Offerings.

Judge Carter sustained subject matter jurisdiction solely on *Leasco* and *Schoenbaum*:

> "Application of the principles espoused in *Leasco* and *Schoenbaum* satisfies the court, as more fully explained below, that subject matter jurisdiction exists" (263A).

However, he doubted the validity of his own conclusion:

> "While the jurisdictional reach of our securities laws has been settled and clarified by our Court of Appeals in *Schoenbaum* v. *Firstbrook*, 405 F.2d 215 [sic] (2d Cir. 1968) and *Leasco Data Processing Corp.* v. *Maxwell*, 468 F.2d 1326 (2d Cir. 1972), there is substantial ground for difference of opinion as to whether the

ratio decidendi of those cases was properly applied in the instant case'' (281A).

We submit that the *ratio decidendi* of those cases was improperly applied, and that those cases in fact compel the conclusion that subject matter jurisdiction is here lacking.

There appears to be no reported decision dealing with extraterritorial application of the American securities laws in a class action, except for *Weaver* v. *United California Bank* referred to above. *Leasco*, *Schoenbaum*, and other decisions in the area are all suits by a single party who was an American citizen. None involved an attempt to use American citizenship of one party to create subject matter jurisdiction over an unmanageable class of non-resident aliens who purchased in a foreign offering, and as to none of whom there would be such jurisdiction had he commenced his own action in the District Court.

(1) The Inapplicability of Schoenbaum

Schoenbaum is a narrowly-circumscribed decision, limited to stock registered with the SEC and traded on an exchange in the United States. There, the plaintiff, an American shareholder of Banff Oil Ltd., a Canadian corporation, sued derivatively under §10(b) for damages to the corporation resulting from sales of treasury stock in Canada.

While this Court recognized ''the usual presumption against extraterritorial application of legislation'' (405 F.2d at 206), it held that there was subject matter jurisdiction because ''[Banff's] common stock is registered with the SEC and traded upon * * * the American Stock Exchange'' (p. 204), and Banff was ''required to comply with the provisions of the Securities Exchange Act'', as enumerated in this Court's opinion (p. 206).

As this Court stated:

> ''We believe that Congress intended the Exchange Act to have extraterritorial application *in order to*

> *protect domestic investors who have purchased foreign securities on American exchanges* and to protect the domestic securities market from the effects of *improper foreign transactions in American securities*" (p. 206).

Subsequently, this Court reiterated that there was subject matter jurisdiction, "at least when the transactions involve stock registered and listed on a national securities exchange, and are detrimental to the interests of American investors" (p. 208).

Judge Frankel's decision in *Investment Properties International, Ltd.* v. *I.O.S., Ltd.* (CCH Fed.Sec.L.Rep. [1970-1971 Transfer Binder], ¶93,011, at 90,726) (S.D.N.Y. April 21, 1971), *aff'd. without opinion* (unreported 2d Cir. 1971),* made clear that subject matter jurisdiction was found in *Schoenbaum* only because its stock was registered with the SEC and listed on a national securities exchange. In holding that the District Court lacked subject matter jurisdiction, Judge Frankel stated that "its shares are not sold in the domestic securities market, and the domestic injury found in *Schoenbaum* does not exist here" (p. 90,738).

Clearly, *Schoenbaum* is inapplicable to IOS stock, which is not registered on any exchange in the United States; is not traded in the United States, or even over the counter; for which there is no market in the United States; as to which there has not been any suggestion of market activity either before or after the three public offerings of IOS stock in September 1969; and where any "improper foreign transactions" were not "in American securities" but in foreign securities.

(2) The Inapplicability of Leasco

Leasco is totally inapplicable and was misconceived and misapplied by Judge Carter.

* This Court's unreported affirmance without opinion is noted in *Investment Properties International, Ltd.* v. *I.O.S., Ltd.*, 459 F.2d 705, 706 n. 1 (2d Cir. 1972).

Judge Carter treated *Leasco* as though its sole test was whether there was "significant conduct within the territory", even though such "significant conduct" did not constitute a fraud practiced on plaintiff. He characterized a view of *Leasco,* which would require a misrepresentation to have been made in the United States, as "somewhat myopic" (267A), and held that, even though in the case at bar "the ultimate representations or inducements do not appear to have occurred in the United States, as was true in *Leasco",* it sufficed if there was "significant conduct" in the United States. His misconception stems from the fact that in its *Leasco* opinion this Court on occasion used the phrase "significant conduct" without always coupling it with the word "fraud" or "misrepresentation". But clearly, those words were always used in the context of the fraud committed in the United States.

Leasco can hardly be cited as holding that if a party engaged in "significant conduct" in the United States, that alone suffices to compel application of the American securities laws, whether or not such "significant conduct" also entailed fraud or misrepresentation in the United States. This view obviously is totally contrary to the SEC release as to foreign offerings, which made it so clear that it is immaterial "whether the offering originates from within or without the United States, whether domestic or foreign brokerage dealers are involved, and whether the actual mechanics of the distribution are effected within the United States" (SEC Release No. 33-4708 and No. 34-3766, dated July 9, 1964).

In *Leasco,* this Court reviewed innumerable meetings, telephone conversations and communications in which the sellers "made various false or exaggerated statements" as to the corporation's performance and prospects; "falsely touting the profitability" of a subsidiary; "falsely spoke in * * * glowing terms of the profitability of that company's operations" in a certain transaction; "made various misrepresentations about the sales and earnings" of the corporation and its subsidiary; mailed to New York a letter

"containing false reports of profits" and a "misleading report" of the corporation's affairs; made "Many further misrepresentations with respect to" the corporation and a subsidiary; made "further false statements"; "misrepresented the profits * * * and included a false statement"; made "other oral misrepresentations"; and "The upshot was an agreement between Leasco and Maxwell, signed in New York on June 17, 1969" (468 F.2d at 1331-2).

Leasco also stressed the relationship between "significant conduct" and misrepresentations. The fact that the fraudulent misrepresentations were made in the United States was repeatedly emphasized as the crux of the decision. After detailing all such fraud in the United States, this Court stated that "we would entertain most serious doubt" as to its jurisdiction "If all the misrepresentations here alleged had occurred in England" (p. 1334) and that it would be "hard pressed" to find jurisdiction "when no fraud has been practiced in this country and the purchase or sale has not been made here" (p. 1334); reiterating that "there were abundant misrepresentations in the United States" (p. 1335).

This Court in *Leasco* found the "'essential link'", which Judge Carter misconceived and misapplied, on the basis that "defendants' fraudulent acts in the United States significantly whetted Leasco's interest in acquiring Pergamon shares" (p. 1335), and felt that Congress intended §10(b) to apply to "The New Yorker who is the object of fraudulent misrepresentations in New York" (p. 1336).

Accordingly, this Court stated that the scales were tipped "in favor of applicability when substantial misrepresentations were made in the United States" (p. 1337). In fact, it suggests that even misrepresentations made in the United States might not necessarily suffice, and that its decision was directed to aliens who came to the United States for the express purpose of making the misrepresentations there so as to induce an American to make a purchase. This is apparent from the following (p. 1338):

> "The case is quite different from another hypothetical we posed at argument, namely, where a Ger-

man and a Japanese businessman met in New York for convenience, and the latter fraudulently induced the former to make purchases of Japanese securities on the Tokyo Stock Exchange".

Finally, in language which makes clear beyond doubt that the essence of *Leasco* was substantial fraudulent acts within the United States, the Court indicated that its view as to subject matter jurisdiction might change "if a trial should disclose that the allegedly fraudulent acts of any of the defendants within the United States were non-existent or so minimal as not to be material" (468 F.2d at 1330).

However, accepting *arguendo* Judge Carter's view of *Leasco*, namely, that it does not require misrepresentations in the United States, but merely "significant conduct," —it is respectfully submitted that even this test is not here met.

It is self-evident that in the case of an offering, such as the $56,000,000 Drexel offering, there will be meetings, planning and preliminary research in the United States, as to whether to undertake the project. But this does not make such activities "significant conduct",—especially when compared with the tremendous work and activity abroad, once it was decided to go forward with the project (see pp. 13-15, *supra*).

Judge Carter aptly described the occurrences on which he based subject matter jurisdiction as "of minimal significance" when "taken by themselves" (267A), but felt that "substantial elements of the offering were structured as a result of this activity" (265A). It is submitted that all the occurrences in the United States listed by Judge Carter,—even if "viewed *in toto*",—are still "of minimal significance", especially when compared with the vast amount of work done abroad.

In *Investment Properties International, Ltd., supra*, the plaintiff relied on exploratory and preliminary activity in the United States, also urging that as a result, "this trans-

action was 'structured' in the Southern District of New York". Judge Frankel rejected this contention, stating that "None of these exploratory discussions between lawyer and client established subject matter jurisdiction" (p. 90,736).

However, even if all the work on the prospectuses had been done in the United States, this still would not sustain subject matter jurisdiction, since the "significant conduct" does not involve misrepresentations to plaintiff.

Reference may again be made to the SEC release that it does not matter "whether the actual mechanics of the distribution are effected within the United States, so long as the offering is made under circumstances reasonably designed to preclude distribution or redistribution of the securities within, or to nationals of, the United States" (see pp. 12, 15-16, *supra*).

Judge Carter hardly considered this aspect. Nowhere does he refer to the voluminous evidence which establishes the rigid measures taken "to preclude distribution or redistribution of the securities within, or to nationals of, the United States". But, he could hardly suggest that the "reasonably designed to preclude" test had not been both fully met and fully effective,—at least as to the Drexel and Crang offerings,—since he stated (268A):

> "It is recognized that the defendants appear to have made an attempt to prevent any sales to Americans. Moreover, no sales to Americans did occur through the Drexel Group or Crang offerings".

And, while Judge Carter states that "approximately 386 [insiders who] were Americans" bought under the IOB offering (256A), he nowhere suggests that any were residents of the United States or had bought in the United States.

In *Investment Properties International, Ltd., supra*, plaintiffs relied on a sale to the public, with IOS as underwriter, and showed that some stock had found its way

into American hands. Judge Frankel deemed this insufficient to sustain subject matter jurisdiction, stating:

> "The short answer to this, again is that the underwriting and distribution occurred entirely outside the United States, and, with the exception of sales to IOS-related personnel, permitted by the SEC, the shares were sold solely to non-United States citizens and residents. The prospectus itself states the latter restriction" (p. 90,738).

Accordingly, Judge Frankel found it "irrelevant * * * to establish subject matter jurisdiction" that after the alleged fraudulent issuance, some "shares were able to make their way into American hands" (p. 90,738).

C. There Is No Subject Matter Jurisdiction Over Andersen.

Assuming, *arguendo*, that "significant conduct" can create subject matter jurisdiction, despite absence of misrepresentations in the United States, and that Drexel's activity here was "significant conduct", Drexel's "significant conduct" cannot be attributed to Andersen, a wholly independent party who was not employed by and had no connection with the underwriters, other than its consent, given abroad, to the use of its name in the prospectuses and to furnish in Geneva a "cold comfort" letter as to the stub period (see p. 29, *supra*).

Leasco indicated that for purposes of determining subject matter jurisdiction, the fraudulent acts of each defendant within the United States should be separately considered:

> "[I]f a trial should disclose that the alleged fraudulent acts of *any of the defendants within the United States* were non-existent or so minimal as not to be material, the principles announced in this opinion should be applied to the proven facts; the issue of subject matter jurisdiction, persists" (468 F.2d at 1330).

As to Andersen, there were no fraudulent acts in the United States. Its activity in the United States was so minimal as not only to be not material but, in fact, to be non-existent.

Judge Carter, in dismissing as to Crang, held that "Crang committed no acts within the United States which substantially fostered or made possible the allegedly fraudulent transaction" (275A), and that its "*de minimis* preliminary discussions can hardly be considered acts out of which the cause of action arose" (273A). This has equal application to Andersen.

Andersen's explanation, confirmed in New York, as to why it lacked time for a proper audit for the stub period is not an act which "substantially fostered or made possible the allegedly fraudulent transaction" (275A). Andersen was, in effect, merely saying that the only kind of audit it would do was a thoroughly comprehensive one, which could not be hurried. It was up to the Drexel underwriters to then decide whether to postpone their offering date to enable Andersen to make such comprehensive audit, or to proceed with their time schedule and forego audited statements for the stub period. The Drexel Group selected the latter course, based on reassurances from their own accountants, Price Waterhouse, six members of whom had spent many weeks in Geneva making their own verification.

As already noted, plaintiff's claim against Andersen is on the basis of Andersen's being an "aider and abettor". If, as Judge Carter held, to constitute an aider and abettor, there must have been acts in the United States which "substantially fostered or made possible the allegedly fraudulent transaction", there can be no claim against Andersen, which did nothing in the United States, and certainly did nothing which could even remotely "be considered acts out of which the cause of action arose" (273A).

While Judge Carter cited *Securities Exchange Commission* v. *National Bankers Life Insurance Co.*, 324 F.Supp.

189 (N.D. Tex. 1971), *aff'd*, 448 F.2d 652 (5th Cir. 1971), as allegedly supportive of his "integrated offering thesis" (discussed under D., *infra*), he ignored, with respect to Andersen, the Court's caveat in that case against seeking "to paint them all [the defendants] with the same broad brush"; failing "to distinguish one defendant from the other"; and failing "to properly delineate individual violations" (p. 197).

Furthermore, essential for jurisdiction under Section 10(b) is "the use of any means or instrumentality of interstate commerce or of the mails" to accomplish the "unlawful" purpose interdicted by Section 10(b). Certainly, as to the 99,614 non-resident aliens who bought, paid for and received their IOS stock in Europe, Asia, Africa, Australia and South America, there was no use of an "instrumentality of interstate commerce or of the mails" of the United States to accomplish an alleged fraud,—especially as to Andersen. At least no one has pointed to any such use. Judge Carter's opinion fails even to consider whether any means or instrumentality of interstate commerce or of the mails was used by Andersen or any defendant in this case to accomplish an alleged fraud. It merely states, in a vacuum, without relating it to anything in particular in the case, or to any particular defendant or defendants, that "Instrumentalities of interstate commerce were commonly used" (267A).

Judge Carter erroneously assumed that mere use of mails and other instruments of interstate commerce suffice for subject matter jurisdiction, even though not used to accomplish the alleged fraud. He stated that "As in *Leasco*, the mails and other instruments of interstate commerce were a necessary part of the domestic activity" (268A). But in *Leasco*, the "domestic activity" was the fraudulent activity, whereas Judge Carter recognized that "in the instant case the ultimate representations or inducements do not appear to have occurred in the United States" (268A).

D. The District Court Misconceived and Misapplied the SEC Concept of Integration on Which It Based Subject Matter Jurisdiction.

To reach out and acquire jurisdiction over the Drexel and Crang offerings, Judge Carter, as already noted, applied what he called his "integrated offering thesis" and held that "the three offerings should be considered a single transaction for purposes of subject matter jurisdiction" (268A). In fact in granting his §1292(b) certification, Judge Carter stated that "The basis for the court's determination [that there is subject matter jurisdiction] was that the tripartite offerings involved were an integrated entity and not three distinct, separate and independent transactions" (281A).

This novel approach misconceives and misapplies the integration concept, which merely concerns whether an offering is public, thereby requiring registration, or exempt as private. Integration prevents an issuer from circumventing a required registration by separating a single offering into a series of offerings, each of which, if really separate, would be exempt.

Thus, while an issue is exempt from registration under Regulation A if $500,000 or less, a $1,500,000 offering could not be separated into three offerings of $500,000 each and thereby become exempt; the offerings would be integrated and deemed one, with registration required.

Similarly, if an offering is exempt because there are "no more than thirty-five purchasers" (SEC Rule 146 (g)), registration could not be availed of, if there were really 105 purchasers, by having three separate offerings. Through integration, they become one issue requiring registration.

The SEC concept of integration, for which specific rules and guidelines have been prescribed, has no relationship to the three separate public offerings here involved. This is not a situation where a single offering, for which reg-

istration would have been required, was separated into three. Registration was not required as to any of them, whether deemed one or three offerings, because they were foreign offerings of a foreign corporation. Were they domestic offerings, they would be subject to registration, whether one offering or three. When Shearman & Sterling advised the SEC that the offering and sale could be "made without registration of the shares to be offered" (212A), the SEC took no action to require registration,—integrated or not integrated.

There were cogent business and financial reasons for having three separate IOS offerings. Drexel was handling the primary offering. Drexel, basically working out of Geneva, had no interest in the Canadian secondary offering, or in meeting the requirements of the eleven provincial securities commissions and the Canadian Federal Securities Commission. Crang of Toronto was well equipped to distribute shares in Canada.

On the other hand, since the third offering was exclusively for directors, officers, employees and other insiders of IOS, an outside underwriter was not needed. It was logical to have IOB, an IOS subsidiary, handle these sales, which were essentially being made to the IOS staff. As already noted, plaintiff, when seeking to buy his shares, did not even await a prospectus, but merely mailed a subscription form directly to IOS' main office in Geneva (see p. 19, *supra*).

Judge Carter recognized that the underwriters had "gone to great pains to refer publicly to the offerings as separate and distinct" and that "each offering had unique characteristics and some non-identical parties" (256A). Indeed, the three offerings are so dissimilar that they could not, under any circumstances, be treated as an integrated offering, but only as three separate offerings. Some of the dissimilarities are as follows:

(1) The Drexel Group offering for 5,600,000 shares, or $56,000,000, was a primary offering, with the proceeds go-

ing to the issuer, IOS, itself. Both the IOB offering for 3,950,000 shares, or $39,500,000 and the Crang offering for 1,450,000 shares, or $15,600,000, were secondary offerings, with the proceeds going to selling stockholders. This distinction alone should suffice to prevent integration.

(2) The underwriters were entirely different; the Drexel Group on one; IOB of the Bahamas on the second; and Crang of Toronto on a third.

(3) The sales territories differed. Sales under the Drexel offering were made only in Europe, Asia and Australia; sales under the IOB offering were made in Europe, Asia, Australia, Africa and South America; sales under the Crang offering were limited to Canada.

(4) The authorized purchasers under the three offerings were different. The Drexel offering was confined to non-resident aliens outside the Western Hemisphere; and the Crang offering to Canada only, but not to Americans resident in Canada. The IOB offering was not public, in the sense of the Drexel and Crang offerings, where any member of the public could buy. Sales were limited to directors, officers, employees and other IOS insiders, except that sales to resident citizens of the United States were barred.

(5) Each offering had a separate closing in separate localities: Drexel in London, Crang in Toronto, and IOB in Nassau.

(6) No underwriter under one offering shared in the fees of other underwriters in other offerings.

(7) The Drexel prospectus was drafted by New York counsel for Drexel; the Crang prospectus was drafted in Canada by Canadian lawyers; and the IOB prospectus was drafted by counsel for IOS, IOB's parent corporation. The text of the Crang prospectus is different from the Drexel prospectus, since the former had to comply with special requirements of each of ten provincial securities commis-

sions in Canada, as well as the Canadian Federal Securities Commission. Mere examination of the table of contents of each of the three prospectuses will show that each is different in scope, arrangement and subject matter, regardless of certain necessarily similar material (169A, 185A, 188A-1).

(8) While Drexel and Smith, Barney personnel spent three months in Geneva preparing the Drexel prospectus and investigating IOS, Crang and its Canadian lawyers did not rely on the Drexel investigation, but conducted their own investigation of IOS in Canada and Switzerland.

Judge Carter's "integrated offering thesis", as here postulated and applied, is so novel and farfetched, that neither plaintiff's counsel nor the District Court could find authority anywhere in support,—either in a decided case or in any SEC ruling, release, regulation or otherwise, notwithstanding the SEC regulations and releases as to an integrated offering. Judge Carter himself recognized this when he called it a "thesis". Accordingly, he used the "aider and abettor" concept to support this "integrated offering thesis, which allows for collective consideration of the defendants", citing two District Court cases (259A, fn. 2).

Neither case, however, bears the remotest relationship to his "integrated offering thesis." The first case,—*Securities and Exchange Commission* v. *National Bankers Life Insurance Co., supra*, 324 F. Supp. at 194,—merely holds that one can be an aider and abettor of a Section 5 violation, when a required registration was not effected, quoting from *Nees* v. *Securities and Exchange Comm.*, 414 F.2d 211, 220-221 (9th Cir. 1969) that one can be such an aider and abettor if he " 'had reason to know or should have known that the securities should have been registered.' "

Accordingly, to apply the "aider and abettor" concept to Andersen means that Andersen's Zurich office, man-

aged by an Italian resident,—w[illegible]had nothing to do with the registration, other than to consent to use in the prospectuses of Andersen's opinion as to the 1968 statements, —must be charged with having "known that the securities should have been registered." Andersen must be so charged, though Shearman & Sterling, as counsel for the Drexel offering, was of the opinion that registration was not necessary and the SEC apparently concurred.

E. Subject Matter Jurisdiction Cannot Be Supported by Alleged "Impact" of the IOS Collapse on American Investors and the American Securities Market.

Judge Carter based jurisdiction in part on an extraordinarily vague and amorphous concept, namely, "the impact which the transaction in question had upon American investors and the American securities market" which he stated was "integral to the finding of jurisdiction" (268A).

It defies imagination to understand how jurisdiction can be based on a finding that a transaction which took place abroad had an impact "upon American investors and the American securities market", or the kind of presentation, or possibly mini-trial, required to demonstrate such "impact" in order to establish federal jurisdiction.

And if "impact" "upon American investors and the American securities market" is a basis for federal jurisdiction, how much "impact" is needed, and how is "impact" to be measured? Endless opportunity for speculation and theorizing is presented.

To support his "impact" basis for jurisdiction, Judge Carter relied on the Mendelson affidavit, as findings based on "a study of I.O.S." Mendelson's affidavit merely states that he was "retained by plaintiff to make a study" to determine whether the IOS public offering "had an effect upon the U.S. securities markets and American investors" (71A-1). Nowhere does he describe the measure, extent,

depth or scope of this "study". But he concludes that the IOS offerings "had an adverse effect upon our securities markets and investors" (71A-1, A-2)

The only support given for the "study" is a statement as to the decline in net purchases of United States stocks by foreigners from 1969 through May 1970,—"(Source: Federal Reserve Bulletin)",—without the date, issue, title or other method of identification (71A-1, A-3). Professor Mendelson, to demonstrate the decrease in net assets of Fund of Funds, a mutual fund managed by IOS, merely states: "I have been advised by Sidney B. Silverman, Esq., attorney for the plaintiff, that Fund of Fund's present net asset value is $110,000,000" (Aff., p. 4) (71A-4).

Professor Mendelson then states that two-thirds of its assets were invested in United States securities; and that through redemptions the net asset value of the fund dropped from $675,000,000 to $110,000,000,—the figure furnished him by plaintiff's counsel.

An expert, of course, can glibly state that he made a study and opine that the IOS collapse "had an adverse effect upon our securities markets and investors", citing such decrease in net asset value of Fund of Funds. However, relevant to this adverse effect on "our securities market and investors" is that long before the IOS collapse,—which took place in April or May of 1970,—there had been a steady, continuing decline in the stock market in New York, which began in 1969 and continued through 1970.* Such substantial decline in the securities market may well have caused the decrease in the net asset value of Fund of Funds. And, perhaps such decline in market valu in the United States may well have caused the IOS collapse, not the collapse of IOS which caused the decline.

* The Dow Jones Index reached 985 in 1968, and then began to drop steadily, reaching 746 on February 2, 1970 and 631 on May 26, 1970. Then, with minor exceptions, it began to rise, reaching 794 on December 1, 1970 (ISL Daily Stock Index). The collapse of IOS took place in late April or early May, 1970.

The SEC, which made a far more comprehensive study of this redemption problem than Mendelson, has reported:

> "To the extent that IOS had to sell portfolio securities in order to raise cash to meet its shareholders' requests for redemptions, there is concern about the impact on U.S. market stability when a fund complex the size of IOS sells off its large holdings of U.S. securities. Is there a significant direct effect on general market stability? *Overall, the answer is probably not, given the size and breadth of the U.S. market.*"*

In any event, it should be self-evident that speculation as to such alleged impact "upon American investors and American securities market" provides no possible standard for determining federal jurisdiction, whether or not one indulges in abstruse analysis as to the difference between the "subjective territorial principle" and the "objective territorial principle", as discussed by Judge Carter (260A-262A).

Judge Carter recognized the vagueness of the "impact" basis for jurisdiction, and stated that "proof of a clear correlation between the failure of the I.O.S. offering and the above-mentioned results is difficult to document". Hence, he merely concluded that "some credence must be given to the general proposition" that the collapse of IOS "would have a negative impact on the American market" (269A)—an impact which he held to be "an element integral to the finding of jurisdiction" (268A).

Having found jurisdiction in part upon "impact", Judge Carter then indicated that there was actually little before him to show "impact" (274A):

> "Moreover, as noted in the section on subject matter jurisdiction, *supra,* the impact on the American securities market of the I.O.S. offering was, in fact, less than direct. *The absence of clearly provable or prob-*

* Institutional Investor Study Report, Vol. 3, H.R. Doc. No. 64, 92nd Cong., 1st Sess., pt. 3, p. 947 (1971).

able negative domestic impact is close to fatal in the context of personal jurisdiction, where impact *per se* is not the gravamen * * *."

How can a federal court possibly predicate subject matter jurisdiction over a foreign transaction, in the face of his own finding of "absence of clearly provable or probable negative domestic impact"? If such absence of proof is "close to fatal in the context of personal jurisdiction", it is even closer to "fatal" in the context of subject matter jurisdiction.

F. A Decision That the District Court Has Subject Matter Jurisdiction Over the Three IOS Public Offerings Would Be a Precedent for Establishing Subject Matter Jurisdiction Over Five Billion Dollars of Foreign Offerings Made Through Wholly-Owned Subsidiaries of American Corporations.

In a statement made January 1, 1968 (Balance of Payments Report, ¶101), President Johnson sought to restrict capital export and reduce the balance of payments deficit through various measures, such as deferral of non-essential travel abroad, and use of foreign source funds for direct investment abroad by sale of securities to foreigners.

The Eurodollar bond concept evolved to finance American business growth in Europe, with dollars raised in Europe through sales to Europeans, and thereby diminish flow of American money abroad. To accomplish this, an American corporation would form a wholly-owned foreign subsidiary,—usually in the Netherlands Antilles,—which would sell its bonds in the European market. Since the offerings were entirely foreign, they were made under the same circumstances and restrictions as the three IOS offerings,—namely, prohibition against any sales in the United States and against sales to Americans resident abroad.

The SEC, in Release No. 33-4708 and 34-7366, dated July 9, 1964, in an effort to spur such financings, made it

clear that, since the American securities acts "were intended to protect American investors", registration would not be required if there was compliance with the "reasonably designed to preclude" test (see p. 12, *supra*). To make these Eurobonds salable, interest and principal had to be guaranteed by the American parent. If such foreign operations were successful, and profits repatriated, then not only was export of American dollars restricted, and Eurodollars employed to finance offshore operations, but there would also be a favorable impact on the American balance of payments.

In recent years almost five billion dollars of Eurobonds, —many convertible into common stock of the American parent guarantor,—were sold in Europe by 191 foreign subsidiaries of American parent corporations.* Moody's shows that one of the offerings is by Leasco Data Processing Equipment Corp., which made the offering through its Netherlands Antilles subsidiary, Leasco N.V.

In *Leasco,* this Court considered the relationship between such an American parent and its wholly-owned foreign subsidiary, and noted that Leasco N.V. was "wholly-owned and its debt securities were guaranteed by Leasco and were convertible with Leasco common stock", and that "the foreign entity was accepted by both sides as the *alter ego* of the American" (468 F.2d at 1338). Such an *alter ego* relationship would be equally true of most, if not all, of the 191 American corporations listed in Moody's as having effected such five billion dollars of Eurobond offerings.

The *alter ego* relationship between the American parent corporation and the foreign entity is obviously extremely close,—especially where the Eurobonds are convertible into stock of the parent. Accordingly, the relationship under such Eurobond offerings is less foreign and more American in character than the three IOS offerings made by a foreign corporation which did not have an American parent.

* Moody's Industrial Manual (1974), Vol. 1, A-I, pp. a199-a201.

Since these offerings are foreign and the federal securities laws are "primarily intended to protect American investors", a registration statement is not required for Eurobonds.

The SEC recognizes that, since the offerings are made through a wholly-owned subsidiary of an American corporation, all the work may be done in the United States; hence, as already noted, it does not matter "whether the actual mechanics of the distributions are effected within the United States" (Release No. 33-4708 and 34-7366, *supra*). The only requirement is compliance with the "reasonably designed to preclude" test.

Such test presupposes that somehow, somewhere, an American citizen or resident might manage to buy Eurobonds in such an offering. If there is subject matter jurisdiction over the three IOS offerings based on the preliminary, exploratory and planning activities in the United States by the Drexel Group, *a fortiori* would there be subject matter jurisdiction over actions based on alleged misrepresentations contained in the prospectuses for such five billion dollars of Eurobonds, where all the work required for such offerings,—not merely exploratory, preliminary and planning work, as in the case of the three IOS offerings,—is normally done in the United States. Accordingly, if there should be subject matter jurisdiction over the three IOS offerings, which could then be subject to a class action, there would be subject matter jurisdiction in the federal court under the federal securities laws as to such five billion dollars of Eurobonds, if an American holder suffered a loss and, claiming misrepresentation in a prospectus, commenced suit as class representative of all the foreign buyers, though the SEC has consistently considered such offerings beyond the purview of its regulatory jurisdiction.

POINT II

Under *Snyder* v. *Harris* and *Zahn* v. *International Paper*, the District Court has no jurisdiction over the claims of the 99,614 non-resident aliens who purchased their IOS stock abroad.

A. This Court May Consider the Issue of Whether It Has Jurisdiction Over the Claims of Such Non-Resident Aliens, Even Though Such Issue Was Not Expressly Decided by Judge Carter and Was Not Posed as a Controlling Issue of Law Under Section 1292(b).

The jurisdiction issue has at least two facets: first, whether under *Leasco* and *Schoenbaum*, the American securities laws in this case will be given extraterritorial effect and apply to any aspect of this foreign offering; and, second, whether, assuming some extraterritorial effect, jurisdiction can extend to claims of the 99,614 non-resident aliens, located in numerous foreign countries in Europe, Asia, Australia, Africa and South America, who bought and paid for their stock abroad.

Judge Carter noted among the questions which "Judge Frankel expressly reserved for later determination" by the Judge to whom the case would be "assigned for all purposes", are the issues

> "whether foreign purchasers should be included in the plaintiff class; whether and how the court's ultimate judgment may be made binding upon the foreign class members" (253A).

While Judge Carter did not purport to consider these questions, delineation of a class necessarily presents the basic jurisdictional question whether the District Court's power extends to the 99,614 non-resident aliens who constitute 99.6% of the class, and whether the District Court has jurisdiction and power to bind such non-resident aliens to a judgment. Such basic jurisdictional question is closely re-

lated to, and intertwined with, the subject matter jurisdiction issue to which Judge Carter's opinion is devoted. Accordingly, this Court may appropriately decide the issue of the District Court's power or jurisdiction over the 99,614 non-resident alien class members, though not posed as the controlling issue of law certified under Section 1292(b). For, as this Court has only recently stated in *Capital Temporaries of Hartford, Inc.* v. *The Olsten Corp.*, decided on October 17, 1974 (Slip Op. 121, 124):

> "Once such leave to appeal is granted, the court of appeals 'is not restricted to a decision of the question of law which in the district judge's view was controlling' [citing cases] * * *. [J]udicial economy requires that we address ourselves not only to the question posed but to a closely related jurisdictional question."

See, also, *Leasco*, 468 F.2d at 1344 and *Travis* v. *Anthes Imperial Limited*, 473 F.2d 515, 529 (9th Cir. 1973).

B. The 99,614 Foreign Purchasers Have No Cause of Action Under the American Securities Laws and Could Not Bring Their Own Action in the District Court.

Accordingly, Under *Snyder* v. *Harris* and *Zahn* v. *International Paper*, They May Not Be Included in Plaintiff's Alleged Class.

Snyder v. *Harris*, 394 U.S. 332 (1969),—which held that separate claims for various claimants in a class action may not be aggregated to meet the jurisdictional amount,—reaffirmed that Rule 23, as amended in 1966, could not extend jurisdiction to a claim over which the District Court would have had no jurisdiction before such 1966 amendments.

Zahn v. *International Paper Co.*, 414 U.S. 291, 301 (1973) held that a plaintiff in a class action who satisfied the requisite diversity and jurisdictional amount could not include in the alleged class anyone who lacked the jurisdictional amount:

> "Each plaintiff in a Rule 23(b)(3) class action must satisfy the jurisdictional amount, and any plaintiff who does not must be dismissed from the case—'one plaintiff may not ride in on another's coattails.' 469 F.2d at 1035".

Zahn was not referring to named plaintiffs, since each "was found to satisfy the $10,000 jurisdictional amount". *Zahn* related solely to class members whose claims were less than the jurisdictional amount. The Court read *Snyder* v. *Harris, supra,* "as precluding maintenance of the action by any member of the class whose separate and distinct claim did not individually satisfy the jurisdictional amount" (414 U.S. at 292).

In short, the essence of *Zahn* is that a person who cannot sue in the federal courts as a named plaintiff because of lack of jurisdiction over his claim, may not be part of a class represented by a named plaintiff over whose claim the federal court has jurisdiction.

This Court will recall that under former Rule 23(a)(3), there were three categories of class action,—the true class action, the hybrid class action and the "spurious" class action.

The complaint (¶2) alleges:

> "(b) This action can be maintained as a class action *pursuant to Rule 23(b)(3)* of the Federal Rules of Civil Procedure."

Rule 23(b)(3), as amended in 1966, covers the previous "spurious" class action; some courts continue to refer to a Rule 23(b)(3) litigation as a "spurious" class action. See, for example, *La Mar* v. *H & B Novelty & Loan Co.,* 489 F.2d 461, 467 (9th Cir. 1973).

Moore describes Rule 23(b)(3) as "the mod version of the spurious class action of yore" (Moore's *Federal Practice,* 2d ed., Vol. 3B, p. 701). Elsewhere, Moore states:

> "The lineal descendant of the spurious class action under original Rule 23 is the (b)(3) type of class suit under revised Rule 23" (*Id.* at 2601).

Zahn,—quoting *Steele* v. *Guaranty Trust Co. of N.Y.*, 164 F.2d 387, 388 (2d Cir. 1947),—stated as to the "spurious" class action (p. 296):

> "The spurious class action authorized by Rule 23(a)(3), as it stood prior to amendment in 1966, was viewed by Judge Frank, writing for himself and Judges Learned and Augustus Hand, as 'in effect, but a congeries of separate suits *so that each claimant must, as to his own claim, meet the jurisdictional requirements.*'"

Zahn governs the suit at bar.

As shown above (Point I), the federal securities laws do not apply to the IOS offerings, and there is no subject matter jurisdiction. But assuming, *arguendo*, jurisdiction so far as plaintiff is concerned,—because he is a resident citizen who bought in New York,—then subject matter jurisdiction would be limited to him or to the few other resident Americans whom plaintiff claims also bought in the United States. The issue becomes whether each of the 99,614 non-resident aliens who bought stock from alien underwriters or sellers in Europe, Africa, Asia, Australia and South America, and who constitute over 99.6% of the putative class of 100,000, can "as to his own claim, meet the jurisdictional requirements," so that he could commence his own suit in the federal court under the 1933 and 1934 Acts. If he cannot, then under the clear holding of *Zahn*, there is no federal jurisdiction as to him in a class action brought by plaintiff, even assuming jurisdiction over plaintiff's own claim. Again, to quote *Zahn*, which in turn quoted this Court's decision in *Steele* v. *Guaranty Trust Co. of N.Y.*, each of such 99,614 non-resident alien purchasers "'must, as to his own claim, meet the jurisdictional requirements.'"

Zahn is not limited to diversity actions; the Court there stated:

> "[T]he result here would be the same even if a cause of action under federal law could be stated, see *Illinois* v. *City of Milwaukee*, 406 U.S. 91, 98-101 (1972), or if substantive federal law were held to control the case" (414 U.S. at 302, fn. 11).

The basic issue, therefore, is whether there is judicial jurisdiction over the 99,614 non-resident aliens, who bought outside the United States; who bought somewhere in Europe, Africa, Asia, Australia or South America, from a non-resident alien underwriter; and who paid for and received their stock in such foreign country.

This Court, on the oral argument in *Leasco* found it helpful to illustrate and analyze the jurisdictional issue by postulating a hypothetical case involving a Japanese and a German businessman (468 F.2d at 1338),—an approach which might here also be helpful.

Take, as an example, a Japanese resident of Tokyo who, like plaintiff, acquired 600 shares of IOS stock for $6,000, which he had bought from The Nikko Securities Co. Ltd., a Japanese underwriter (175A). Assume that he first received the Drexel prospectus,—or as plaintiff asserts with respect to his own claim,—received all three prospectuses, either in English or in one of the foreign languages in which the Drexel prospectus was translated, and that he read all three prospectuses and relied on them before he bought.

(1) Such Japanese investor would then know from such prospectuses that IOS is a Canadian company, with its main office in Geneva, and that it has no office in the United States.

(2) He would see that each prospectus states that the offering is not subject to the American securities laws, and therefore has not purported to meet their requirements.

(3) He would know that sales under the Drexel prospectus can be made only to nationals of Europe, Africa, Asia, Australia and South America, provided they reside outside the United States or its territories.

(4) He would also know that sales to United States citizens anywhere in the world or to foreigners in the United States, were prohibited.

(5) He would also know from the Drexel prospectus that there are 91 underwriters, in 13 countries in Europe, Africa, Asia, Australia and South America, and that each of them, including his seller, The Nikko Securities Co. Ltd., had agreed not to sell any IOS stock to any United States citizen anywhere in the world and not to sell to any alien who resides in the United States.

(6) He would also know that there was a separate offering made by the Canadian underwriter, Crang, who was expressly prohibited from selling IOS stock outside Canada, and who agreed to abide by such express restriction.

(7) He would also know that in 1967, the SEC issued an order which prevented sale of IOS stock to anyone within the United States, and also prohibited sale of IOS stock to non-resident United States citizens unless an IOS employee or other insider.

(8) He would also know that there was a separate offering made by IOB, a Bahamas bank, which is an IOS subsidiary, but that such offering was limited to such insiders, as authorized by the SEC order, provided that resident American citizens were prohibited from buying, and he would also know that this Bahamas bank had agreed to abide by such express restriction.

(9) He would also know that the prospectuses, dated September 24, 1969, include financial statements, as of December 31, 1968, as to which Andersen's Zurich office had expressed an opinion.

(10) He would also know that the IOS stock is not listed or traded on any stock exchange in the United States, and is not traded over the counter in the United States.

(11) He would also know, from his own transaction, that he paid The Nikko Securities Co. Ltd. for his stock in Tokyo and received his stock in Tokyo.

(12) He would also know that, in making his purchase, neither he nor The Nikko Securities Co. Ltd. used the United States mails or any instrumentalities of interstate commerce of the United States in connection with the purchase or sale of such 600 IOS shares.

This Japanese investor, having lost his entire $6,000 investment, may feel that he was misled by the financial statements in the prospectuses as to which Andersen had expressed an opinion.

Such Japanese investor, with only a $6,000 investment, could not sue Andersen in the District Court on diversity jurisdiction, since he lacks the requisite amount in controversy. Could he, as a non-resident alien, assert protection of the American securities laws as to which there is no "matter in controversy" requirement?

Could Andersen and the underwriters be held to the standards of a registered offering, with strict adherence to all SEC requirements, and face a cause of action for alleged non-compliance? If so, then even though registration was not required, the effect would be to hold Andersen and the underwriters to precisely the same standards and requirements as if the stock had been registered.

While the complaint alleges that "Andersen failed to observe generally accepted accounting principles in connection with its audit of IOS" (14A-15A, ¶14), could such Japanese buyer claim the full protection of American accounting principles? And while the complaint alleges that "the prospectuses, which contained financial state-

ments of IOS certified by Andersen, were false and misleading" (15A, ¶14), would such Japanese buyer have the right to sue in the United States courts for misrepresentations made in Japan, and not even be required to have the requisite amount in controversy?

What could such Japanese buyer point to in the 1933 or 1934 Acts,—or in any court decision rendered up to the present time,—which shows Congressional intent to grant the District Court jurisdiction over such an action against Andersen in New York?

If The Nikko Securities Co. Ltd. had mailed a prospectus to his office in Tokyo, could this Japanese investor establish the jurisdictional requirement under Section 10(b) that Andersen had committed a fraud "by the use of any means or instrumentality of interstate commerce or of the mails"? Or does the word "mails" mean the United States mails, not Japanese mails? As already noted, in *Weaver* v. *United California Bank, supra,* a class action involving both citizen and non-resident aliens, the Court dismissed the non-resident aliens from the case, because Europeans are not "afforded the protection of the United States security legislation"; that "Subject matter jurisdiction depends on 'use, indirectly or directly of any means or instrumentality of interstate commerce or of the mails' "; and that there was no jurisdiction as to non-resident aliens since "the European members lived in Europe, were solicited in Europe by offerings and prospectuses generated in Europe and, in Europe, consummated their investment in this European Bank."

The foregoing would also be true as to the German who bought from Allgemeine Bankgesellschaft Aktiengesellschaft in Berlin; the Dane who bought from Den Danske Landmansbank in Copenhagen; the Finn who bought from Ab Nordiska Foreningsbanken in Helsinki; and the Australian who bought from Ord-B.T. Co. Limited in Sydney (175A). The same would also be true as to each of the 99,614 non-resident aliens, constituting over 99.6% of the

IOS buyers, who bought in countries of which they were nationals from dealers in their native lands.

Since the Japanese investor bought his stock in Tokyo and received and relied on the prospectus in Tokyo,—even if the prospectus contained an untrue statement or omission,—any fraud was practiced in Japan. *Leasco* made it clear that there would be no jurisdiction (468 F.2d at 1334):

> "When no fraud has been practiced in this country and the purchase or sale has not been made here, we would be hard pressed to find justification for going beyond *Schoenbaum*."

Since such Japanese and each of the other 99,613 foreign buyers " 'must, as to his own claim, meet the jurisdictional requirements', *Steele* v. *Guaranty Trust Co. of N.Y.*, 164 F.2d 387, 388 (C.A.2d 1947)" (*Zahn* v. *International Paper Co.*, 414 U.S. at 296),—which he obviously fails to do,—he may not be represented in a class action by a claimant such as plaintiff, who may "individually satisfy the jurisdictional requirements",—apart from the basic issue of whether there is subject matter jurisdiction as to any part of the offerings.

C. The District Court Lacks Judicial Jurisdiction to Bind to a Judgment 99,614 Non-Resident Aliens by Mere Notice Mailed to Their Last-Known Address.

Leasco noted that, despite the most expanded scope to be given to §27 of the 1934 Act, the due process clause necessarily applies to efforts to bind foreigners: "[W]e hold that Congress meant §27 to extend personal jurisdiction to the full reach permitted by the due process clause" (468 F.2d at 1339). Also, "Congress meant to assert personal jurisdiction over foreigners not present in the United States to but, of course, not beyond the bounds permitted by the due process clause of the Fifth Amendment" (p. 1340).

Then, after review of *Hanson* v. *Denckla*, 357 U.S. 235, (1958) and other authority, *Leasco* stated that where a person "has acted within a state or sufficiently caused consequences there, he may fairly be subjected to its judicial jurisdiction even though he cannot be served with process in the state" (*Id.*).

Due process considerations as to class action were not and could not be repealed by Rule 23. The Advisory Committee Notes recognize that any notice must "fulfill requirements of due process to which the class action procedure is of course subject" (39 F.R.D. 69, 107). *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156, 173-4 (1974), quoted this statement of the Advisory Committee, and noted its purpose of "incorporation of due process standards".

A basic change accomplished by Rule 23(b)(3) and (c)(3) is to include in the judgment in a class action "whether or not favorable to the class," those to whom a class action notice was sent and "who have not requested exclusion". As Moore put it, the effect of Rule 23(b)(3) is "the expansion of the reach of the judgment, which now binds all members of the class who do not exclude themselves" (3B J. MOORE, *Federal Practice* ¶23.45[1], at 23-702 (2d ed. 1974)).

Rule 23 applies to all members of a class, whether a plaintiff class or a defendant class. It does not purport to distinguish between plaintiff or defendant members, or those within or without the United States. Under its language, a mere notice suffices to bind to a judgment, whether favorable or unfavorable, each person to whom the notice is addressed, whether or not the notice is actually received.

There is no requirement that a recipient of the notice who is "not present within the territory of the forum", but is nevertheless to be bound by the judgment, should "have certain minimum contacts with it" (*International Shoe Co.* v. *Washington*, 326 U.S. 310, 316 (1945)). There is no requirement that such recipient of the notice purposely avail himself "of the privilege of conducting activities

within the forum State, thus invoking the benefits and protections of its laws'' (*Hanson* v. *Denckla,* 357 U.S. 235, 253 (1958)).

There is no requirement that such recipient of the notice ''has acted within a state or sufficiently caused consequences there, [that] he may fairly be subjected to its judicial jurisdiction even though he cannot be served with process in the state'' (*Leasco,* 468 F.2d at 1340).

While *International Shoe, Hanson* and *Leasco* were not addressed to a class action notice, but to process in ordinary litigation, due process principles there stated should apply *a fortiori* to a mere notice. Both the process and the notice have the same purpose,—to bind a person to a judgment. Indeed, the standard for process might be more rigidly applied to a mere printed notice than to formal process in a lawsuit. A person receiving a summons or other formal process, especially if sent by certified mail or personally served outside the forum, is more apt to be impressed with its significance and need for response, than he would be as to a mere printed notice by ordinary mail, which might resemble much of the routine, throwaway matter normally received in quantities, and he might be less apt to appreciate the full significance of the notice.

Judge Frankel has indicated the possible lack of due process involved in a mere notice or newspaper publication:

> ''To a generation raised on Pennoyer v. Neff, 95 U.S. 714, 24 L.Ed. 565 (1877), it is a rather heady and disturbing idea to be told that people in faraway places who receive a letter or are 'described' in a newspaper 'notice' which does not come to their attention are exposed to a binding judgment unless they take some affirmative action to exclude themselves''. (''Some Preliminary Observations Concerning Civil Rule 23'', 43 F.R.D. 39, 45 (1967)).

Perhaps, because of nationwide service under the securities acts, mere notice sent anywhere in the United States might satisfy ''due process''. But there is no comparable

provision in the securities acts for worldwide service. And this Court has only recently stated that the constitutional requirement of "minimal contacts" for service outside the forum, though not applicable to United States residents because of nationwide service under the 1934 Act, would be required for "extraterritorial service of process", which "raises a question of the forum's power to assert control over the defendant." *Mariash* v. *Morrill*, 496 F.2d 1138, 1143 (2d Cir. 1974).

Accordingly, it would appear clear that, assuming *arguendo*, that there is general subject matter jurisdiction, the District Court cannot, by merely mailing a notice, exercise what *Leasco* called "judicial jurisdiction over an individual who is not present", if he is a non-resident alien of the United States, such as the Japanese buyer postulated in the above example, who bought his IOS stock from The Nikko Securities Co. Ltd. in Toyko.

V. To Allow the 99,614 Non-Resident Aliens to Be Members of a Class in an Action Brought in the United States Would Frustrate the Intent of Rule 23, as Amended in 1966, to Eliminate One-Way Intervention.

Under former Rule 23(a)(3) where only persons who actually intervened were bound by the judgment, "one-way intervention" resulted. Courts held that after a class representative prevailed on the merits, others could intervene and take the benefits. But, if the decision was unfavorable, they could remain outside the case and relitigate in another forum.

American Pipe & Construction Co. v. *Utah*, 414 U.S. 538, 547 (1974), referred to the unfairness of such "potential for so-called 'one-way intervention' ", which it described as a "recurrent source of abuse", and stated that "The 1966 amendments were designed, in part, specifically to mend this perceived defect in the former Rule".

A decision that the District Court has judicial jurisdiction over the 99,614 non-resident aliens would perpetuate

the "one-way intervention" which the 1966 Amendment was designed to prevent.

If, after trial on the merits, plaintiff should obtain his requested judgment against defendants of $110,000,000 with interest, the 99,614 non-resident aliens would, if they became aware of this result, certainly seek payment of their losses. However, if judgment were rendered in defendants' favor, these non-resident aliens would not be bound.

Affidavits of leading counsel in principal European countries in which IOS stock was sold uniformly expressed the opinion that any adverse judgment in a United States class action would not be binding in their countries, and could be there litigated.*

Judge Frankel groped for a possible solution to this dilemma: He recognized that "if defendants prevail against a class, they are entitled to a victory no less broad than a defeat would have been", and suggested, "in the court's discretion that putative members be required to 'opt in' or to face exclusion from the class for all purposes" (83A). However, Rule 23 is limited to "opting out", and has no provision for opting in. Further, Avvocato Graziadei stated that in Italy, an Italian who opted in and "agreed to be bound by the judgment of this Court" would nevertheless not be prevented "from maintaining a subsequent suit in an Italian court on the same cause of action against the same defendant" (126A).

Judge Frankel indicated that perhaps these numerous foreign countries might have short statutes of limitations, which might bar subsequent suit and thereby minimize the unfairness of such inherent one-way intervention. He stated that "It may, as has been suggested, become a moot question as supervening limitations periods render this in fact the only practical forum for asserted claims by foreign purchasers (83A-84A).

* See the affidavits of Ercole Graziadei, an "avvocato" in Rome and Milan (126A); of Charles Jolibois, an "avocat" in Paris (147A); and of John Godfray LeQuesne, a barrister of the Inner Temple of London (161A-14).

However, it is submitted that a United States District Court either has or has not judicial jurisdiction in a class action over non-resident aliens. Its jurisdiction cannot depend on a prior determination whether, in such alien's native land, there may be an applicable statute of limitations which might bar suit there,—especially in view of the many factors which might cause a statute to be tolled. It would make the morass even more impenetrable for a District Court, as a basis for asserting judicial jurisdiction over non-resident aliens, first to have to determine whether his claim had been barred by a statute of limitations defense in his native country or would be barred before a judgment could be rendered in the United States.

Furthermore, the Jolibois affidavit indicates that a French action would lie under Article 1382 of the Civil Code, for which the applicable statute of limitations is thirty years (146A). While the nature of these unmanageable class actions is such that many years of litigation are inevitable,—as exemplified by *Eisen* v. *Carlisle & Jacquelin, supra,* where "Eight years have elapsed * * * [and] Both the parties and the courts are still wrestling with the complex questions surrounding petitioner's attempt to maintain his suit as a class action" (417 U.S. at 159),—hopefully this litigation can be completed before expiration of the French limitations period.

In short, there is no way out of the "one-way intervention" as to these 99,614 non-resident aliens other than a holding that the District Court lacks judicial jurisdiction over them.

POINT III

There is no jurisdiction over the underwriters and Andersen, by reason of Section 30(b) of the 1934 Act.

The complaint also relies for jurisdiction on Section 15(c)(1), relating to fraudulent devices as to "brokers or dealers", an allegation which in effect asserts that the underwriters are "brokers or dealers" within the meaning of the 1934 Act.

The term "broker or dealer" is also used in Section 30, subdivision (b) of which provides that the 1934 Act,—therefore including Section 10(b) and Rule 10b-5,—"shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States", unless in violation of some other SEC Rule or Regulation.

The uncontradicted evidence before Judge Carter establishes that both Drexel and Smith, Barney had offices abroad. The Coleman affidavit states that "Drexel Firestone conducted all its solicitation and selling activities in the Primary Offering through its offices in Brussels and Paris", and believes that "Smith Barney did likewise" (58A). The Bischof affidavit confirmed that Smith, Barney also handled the matter through its Paris office (117A).

Although Section 30(b) of the Securities Act expressly applies "to any person insofar as he transacts a business in securities without the jurisdiction of the United States", Judge Carter stated that this provision should not be interpreted "literally", because *Schoenbaum* v. *Firstbrook*, "held that §30(b) does not exempt those who engage in isolated foreign transactions" (270A). *Schoenbaum* merely held that "while section 30(b) was intended to exempt persons conducting a business in securities through foreign securities markets from the provisions of the Act, it does not preclude extraterritorial application of the Exchange Act to *persons who engage in isolated foreign transactions*" (405 F.2d at 207).

However, there was no reason for Judge Carter to assume that the IOS offering was an isolated foreign transac-

tion, and that Drexel and Smith, Barney engaged only "in isolated foreign transactions". On the contrary, since Drexel and Smith, Barney both maintained regular offices in Brussels and in Paris, they obviously were conducting a regular business in securities in the foreign securities market. Since the sale of the IOS securities was made entirely "without the jurisdiction of the United States", and since both Drexel and Smith, Barney maintained such regular European offices where they conducted business in securities, the IOS transaction cannot be presumed to be an isolated foreign transaction, and Section 30(b) renders Section 10(b) and Rule 10b-5 inapplicable to the underwriters.

The sole basis for the claim against Andersen is that it aided and abetted the underwriters. Accordingly, if no claim is stated against the underwriters, by reason of application of Rule 30(b), "then plainly no claim is stated against the aider and abettor" (*Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F.2d 963, 970 (2d Cir. 1969), *cert. denied*, 399 U.S. 909 (1970)).

POINT IV

This Court has inherent power to make a class action determination.

It should determine that plaintiff, an American citizen, resident of New York, is not a proper representative of a class, over 99.6% of which consists of non-resident aliens, and that the action should not be maintained as a class action.

It is not entirely clear what, if any, class action determination was made below. Judge Frankel allowed "the case to proceed for the time being as a class action" (82A), but did not determine whether the four Rule 23(a) prerequisites were all present, or whether the standards of Rule 23(b)(3) were met, or whether the action is manageable. Furthermore, he did nothing as to sending a notice to the class, though Rule 23(c)(2) requires the Court to

"direct to the members of the class the best notice practicable under the circumstances",—"an unambiguous requirement of Rule 23", which must be complied with "'[a]s soon as practicable after the commencement of [the] action'" (*Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156, 178 (1974)).

Judge Ryan felt that Judge Frankel "didn't enter any class order. He defined no class * * *. Therefore, what he said was dictum" (192A).

Judge Carter, on the other hand, appeared to disagree with Judge Ryan and, on December 4, 1974, approved a proposed notice to all IOS stockholders, stating that Judge Frankel had "determined that this action may be maintained as a class action on behalf of all purchasers", and setting forth all the requirements of such a notice, including the provision that each class member will be bound by the judgment, whether favorable or not, unless he requests exclusion (291A).

However, none of these three District Court Judges made any determination as to fulfillment of the prerequisites of Rule 23.

Appeal was not taken from Judge Frankel's order, since all defendants shared Judge Ryan's opinion that a class had not really been defined, and viewed Judge Frankel's decision as a mere holding action to enable the actual determination to be made by the judge to whom the case would be assigned for all purposes.

Assuming, *arguendo*, that this Court should hold that there is subject matter jurisdiction; that there is also jurisdiction over the claims of the 99,614 non-resident aliens and the 374 non-resident American citizens who bought abroad; and that Section 30(b) of the 1934 Act is inapplicable; there remains for consideration the making of a class action determination.

While this should normally be made by the District Court, in view of the three-year period since suit was com-

menced, with the case, as Judge Carter stated, "still at an early stage of development" (279A), and since defendants' motions made October 31, 1973 for a definitive class action determination are still pending, without having yet been argued, it is appropriate, and would be in the interests of judicial economy, for this Court itself to make the class action determination.

This Court has broad power on an interlocutory appeal to dispose of issues not directly presented by the appeal. Such power has long been recognized in appeals from grant or denial of a preliminary injunction. While, as a rule, the propriety of grant or denial is the sole issue on appeal, "this rule is subject to a general exception,—the appellate court may dismiss the complaint on the merits if its examination of the record upon an interlocutory appeal reveals that the case is entirely void of merit" (*Hurwitz* v. *Directors Guild of America, Inc.*, 364 F.2d 67, 70 (2d Cir.), *cert. denied*, 385 U.S. 971 (1966)). In accord, *Mast, Foos & Co.* v. *Stover Mfg. Co.*, 177 U.S. 485, 495 (1900); *Denver* v. *New York Trust Co.*, 229 U.S. 123, 136 (1913); *U.S. Fidelity Co.* v. *Brady*, 225 U.S. 205, 206, 214 (1912).

If this Court, on an interlocutory appeal, has power to dismiss on the merits,—the most drastic of all acts,—*a fortiori* has it power to make a class action determination. It should exercise this power in this case, where all the relevant facts are before the Court, and where, after three years, none of the three District Judges before whom the issue was pending has yet made a definitive determination of the Rule 23 prerequisites for maintenance of a class action.

Plaintiff's claim is not typical of the claims of the class, particularly since he bought and paid for his stock three weeks before the public offerings. As Judge Carter noted, "plaintiff's purchase of I.O.S. shares does not appear to have been made in reliance on statements in the Crang prospectus, since that prospectus was sent to the United States after the date of purchase" (273A),—a

statement equally applicable to the Drexel and IOB prospectuses. Other class members, however, may be able to establish reliance on a prospectus.

Furthermore, plaintiff bought his IOS stock with prior knowledge that an SEC injunction barred sale to him, and, in effect, "bootlegged" his stock into the United States, so that he is *in pari delicto* (see pp. 19-20, *supra*). This alone places him in a different situation from the 99,614 non-resident aliens who bought abroad, especially since their purchases may be governed by the laws of their native countries.

Also, plaintiff cannot represent the 374 non-resident citizens. Presumably, they bought under the IOB prospectus and pursuant to the SEC order authorizing sales to IOS directors, officers, employees and other IOS insiders. Some of these buyers represent top management; others may be subordinate employees. Depending on their respective positions with IOS and opportunity for information as to its financial condition, the extent of their knowledge may vary substantially. Accordingly, it is doubtful whether any buyer under the IOB prospectus can be an adequate representative of any other buyer under such prospectus.

The Advisory Committee's Notes state that "a fraud case may be unsuited for treatment as a class action if there was material variation * * * in the kinds or degrees of reliance by the persons to whom they [the representations] were made. See *Oppenheimer* v. *F. J. Young & Co., Inc.*, 144 F.2d 387 (2d Cir. 1944)." (39 F.R.D. 103).

Furthermore, there is no reason to believe that issues arising out of this foreign offering of a foreign corporation, with sales to non-resident aliens made abroad, can best be adjudicated in a United States court. Proceedings involving the IOS collapse are pending in Switzerland, where IOS had its main office (192A-32, 192A-34). A Swiss court is presumably as capable of dealing with this situation as an American court.

As stated in *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 517, fn. 11 (1974), to assume that an essentially foreign situation may best be tried in an American court "demeans the standards of justice elsewhere in the world, and unnecessarily exalts the primacy of United States law over the laws of other countries".

Plaintiff Bersch is the only IOS stockholder who has sued in the United States. It cannot be assumed that all other stockholders feel that plaintiff is such an adequate class representative that other suits are unnecessary. This Court may take judicial notice of the numerous actions filed, based on alleged violations of securities laws, where often 10, 15 or even 50 separate class actions may be brought arising out of the same situation.

Moreover, it should be clear beyond peradventure that this action, if maintained in the United States District Court, is wholly unmanageable. The mere problem of notice to 99,614 non-resident aliens, located in countries on six continents and having a variety of native tongues, alone should suffice as a conclusive presumption of unmanageability.

As observed in the American College of Trial Lawyers, Report and Recommendations of the Special Committee on Rule 23 of the Federal Rules of Civil Procedure, p. 10 (1972):*

> "Consider a class of 100,000 shareholders as plaintiffs in a securities action. Even if discovery and trial or even just the administrative processing of each claim were to consume only one hour, it would require the consumption of 100,000 hours of judicial time. Assuming the luxury seldom enjoyed by most judges of an eight hour work day and five day work week, the class action would require fifty years to conclude."

If the foregoing is true of a class of 100,000 American shareholders, *a fortiori* would it be true as to a class of

* This Report was cited by the Supreme Court in *American Pipe & Construction Co.* v. *Utah*, 414 U.S. 538, 555 (1974).

comparable size, with 99,614 of its members non-resident aliens.

This case does not meet the prerequisites of a class action and this Court should determine that it may not be maintained as a class action.

Conclusion

It is respectfully submitted that this Court should determine that:

(1) The District Court lacks subject matter jurisdiction.

(2) The District Court has no jurisdiction over the claims of the 99,614 non-resident aliens who purchased IOS stock abroad.

(3) There is no jurisdiction over the underwriters or Andersen, by reason of Section 30(b) of the 1934 Act.

(4) This Court should determine that this action may not be maintained as a class action.

DATED: New York, New York
February 3, 1975.

Respectfully submitted,

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ADDENDUM

[Release 33—4708, 34—7366]

Part 231—Interpretative Releases Relating to the Securities Act of 1933 and General Rules and Regulations Thereunder

Part 241—Interpretative Releases Relating to the Securities Exchange Act of 1934 and General Rules and Regulations Thereunder

Registration of Foreign Offerings by Domestic Issuers; Registration of Underwriters of Foreign Offerings as Broker-Dealers

As part of the program to reduce the United States balance of payments deficit and protect United States gold reserves, a Presidential Task Force on Promoting Increased Foreign Investment in the United States Corporate Securities and Increased Foreign Financing for United States Corporations Operating Abroad was appointed in October 1963. This Task Force was charged with developing programs for the increased foreign marketing of domestic securities, with particular emphasis on the securities of United States companies operating abroad, for a review of governmental and private activities adversely affecting such financing, and for an appraisal of the various barriers to such financing remaining in major foreign capital markets. The report submitted to the President by the Task Force on April 27, 1964, contained a number of specific recommendations for actions by both the private sector and the Government. Included in the latter were recommendations that the Securities and Exchange Commission publish a release setting forth its position regarding the applicability of the registration requirements of the Securities Act of 1933 to securities offered by domestic issuers to foreign purchasers, including dealers, and the application of the broker-dealer

registration requirements of the Securities Exchange Act of 1934 to foreign underwriters participating in distributions of securities exclusively to non-residents of the United States. The Commission is publishing this release to implement these Task Force Recommendations.

I. *The Applicability of the Securities Act of 1933 to Offerings of Securities Outside of the United States.* The registration requirements of the Securities Act apply to any offer or sale of a security involving interstate commerce or use of the mails unless an exemption is available. Since "interstate commerce" is defined in section 2(7) of the Act to include "trade or commerce in securities or any transportation or communication relating thereto * * * between any foreign country and any State, Territory, or the District of Columbia," this might be construed to encompass virtually any offering of securities made by a United States corporation to foreign investors. However, the Commission has traditionally taken the position that the registration requirements of section 5 of the Act are primarily intended to protect American investors. Accordingly, the Commission has not taken any action for failure to register securities of United States corporations distributed abroad to foreign nationals, even though use of jurisdictional means may be involved in the offering. It is assumed in these situations that the distribution is to be effected in a manner which will result in the securities coming to rest abroad. On the other hand, a distribution of securities by a United States corporation, through the facilities of Canadian Stock Exchanges may be expected to flow into the hands of American investors and may therefore be subject to registration. Similarly, a public offering specifically directed toward American nationals abroad, including servicemen, would be regarded as subject to registration. Apart

from such situations, however, it is immaterial whether the offering originates from within or outside of the United States, whether domestic or foreign broker-dealers are involved and whether the actual mechanics of the distribution are effected within the United States, so long as the offering is made under circumstances reasonably designed to preclude distribution or redistribution of the securities within, or to nationals of, the United States.

Active trading in the United States of the securities subject to the offering during or shortly after the distribution abroad may raise a question whether a portion of the distribution was in fact being made by means of such trading. However, absent such a situation, if a distribution of securities by a United States corporation is made abroad without registration in reliance upon the foregoing interpretation of the Act, dealers may trade in other securities of the same class in the United States without regard to the time limitations of the dealer's exemptions in section 4(1).

The Task Force also suggests that the Commission's statement extend to simultaneous private placements in this country of a security being offered abroad. This specifically concerns the application of the exemption from registration provided by the second clause of section 4(1) of the Act for "transactions by an issuer not involving any public offering," the requirements for which were discussed in detail in Securities Act Release No. 4552 (27 F.R. 11316, November 16, 1962). Generally, transactions otherwise meeting the requirements of this exemption need not be integrated with simultaneous offerings being made abroad and, therefore, are not subject to the registration requirements of the Act solely because a foreign offering is being made concurrently with the American private placement which otherwise meets the standards of the exemption.

II. *The applicability of Section 15(a) of the Securities Exchange Act of 1934 to Foreign Underwriters.* Generally speaking, section 15(a) of the Securities Exchange Act of 1934 makes it unlawful for any broker or dealer to use the mails or instrumentalities of interstate commerce, including commerce between the United States and any foreign country, to engage in securities transactions otherwise than on a national securities exchange unless he is registered with the Commission. However, if a foreign broker-dealer, participating as an underwriter in a distribution of American securities being made abroad, or being made both abroad and in the United States, limits his activities to (1) taking down securities which he sells outside the jurisdiction of the United States to persons other than American nationals, and (2) participating solely through his membership in the underwriting syndicate in activities of the syndicate in the United States such as sales to selling group members, stabilizing, over-allotment, and group sales, which activities are carried out for the syndicate by a managing underwriter or underwriters who are registered with the Commission, then the Commission will generally raise no objection if the foreign broker-dealer performs these limited functions without registration as a broker-dealer under section 15 of the Act.

If a foreign broker-dealer limits his securities activities in areas subject to the jurisdiction of the United States in the manner described above, then he could participate in any number of such distributions, assuming that he does not engage in such other activities which require registration. Such other activities would include either selling securities into the United States or purchasing securities in the United States for sale to American investors abroad.

[SEAL] ORVAL L. DUBOIS,
Secretary.

JULY 9, 1964.

[F.R. Doc. 64—7236; Filed, July 21, 1964, 8:46 a.m.]

Affidavit of Service by Mail

In re:

Howard Bersch v. Drexel Firestone, Inc., etc.

State of New York
County of New York, ss.:

Harry Minott,

being duly sworn, deposes and says, that he is over 18 years of age. That on February 4th, 1975, he served ~~3~~ 2 copies of the within Brief in the above named matter on the following counsel by enclosing said three copies in a securely sealed postpaid wrapper addressed as follows:

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and depositing same in the official depository under the exclusive care and custody of the United States Post Office Department within the City of New York.

and depositing same at the Post Office located at Howard and Lafayette Streets, New York, N. Y. 10013.

Harry Minott

Sworn to before me this 4th day of Feb. 1975

Jack A. Messina

JACK A. MESSINA
Notary Public, State of New York
No. 30-2673500
Qualified in Nassau County
Cert. Filed in New York County
Commission Expires March 30, 1975